

BRIEFINGS



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Ensuring that Retirement Plan Fees for Florida's Government Employees are Appropriate, Accountable and Competitive

Earlier this decade, we saw the impact of some corporations putting their own interests ahead of plan participants. First there was Enron and then WorldCom. That was followed by day trading and market timing in which a handful of participants drove up the cost to fellow participants by their frequent trading of plan investments.

Throughout the United States these days, much attention is focused on plan fees and whether they are appropriate for the millions of taxpayers who are saving for retirement. Right here in Florida, taxpayer needs are front and center, whether it is the discussion over property tax relief or our own version of the debate on plan fees.

In our very own backyard, taxpayers are learning that their retirement assets might be lower than they think due to insufficiently disclosed plan fees. Interestingly, the Sheriff's Office in Orange County, Florida has filed a class action lawsuit alleging that a leading insurance company is receiving improper kickbacks from fund companies whose products were being offered to the insurer's customers based on a percentage of plan assets gathered and without proper disclosure of the arrangement. The lawsuit also charged that the insurer's revenue-sharing arrangement included payment to a national and state association in exchange for their endorsement of the insurer's products, what many refer to as "pay for play."

As you can see, both locally and throughout the country, transparency in proper fee disclosure is rightfully garnering much attention. It is a fair question to ask, "What should be considered appropriate when it comes to group retirement plan fees that impact the individual?" It is imperative to the integrity of the retirement systems covering Florida's public employees that participants be made fully aware of where their retirement plan assets are going and that any special arrangement revolving around fees be appropriately disclosed to the participants.

Retirement plans incur fees in different ways. There are expenses associated with the day-to-day operation of the plans. Also, there may be investment management fees at various levels depending on the options that are selected for the plan. As we see from both the general media and the retirement industry press, many people believe that plan fees are either excessive or are not clearly presented to participants. This is important because the underlying law governing retirement benefits for private sector employees – the Employee Retirement Income Security Act of 1974, as amended (ERISA) – was designed in large part to ensure that retirement plans are always operated in the best interest of participants.

While retirement plans for our Florida government employees are not subject to ERISA, many of the same concepts, principles and standards that apply to ERISA-covered participants should apply equally to non-ERISA covered plans for the benefit of our public employees and their families. Concern about fees comes from many sources – participants, plan fiduciaries with responsibility over the plan (such as the

State Board of Administration – Governor, Chief Financial Officer and Attorney General), providers to whom sponsors have entrusted the servicing of their plans, and governmental regulators with jurisdiction over the plans.

Media coverage about plan fees may appear alongside reports about the inadequacy of retirement savings. Naturally, this increases participant concerns that their savings are being further eroded. Plan sponsors can take steps to ameliorate the situation by maintaining vigilance pertaining to what they are being charged in the way of administrative/recordkeeping fees and investment management fees. Plan sponsors also can work with either their service provider or their own in-house benefits staff to clearly communicate these fees. In performing due diligence, plan sponsors might want to consider putting the servicing of their plan out to bid on a regular basis – perhaps every five years – to ensure that fees remain competitive and that best practices are followed in the daily operation of the plan.

Washington has its eyes on fees

How important is the topic of plan fees? Both the Legislative and Executive branches of government have placed high priority on giving clarity to this subject. The Employee Benefits Security Administration (EBSA), part of the U.S. Department of Labor, is seeking input from concerned parties on proper fee disclosure. The House Education and Labor Committee of the U.S. House of Representatives recently conducted hearings on fee disclosure and intends to take further action. The U.S. Government Accountability Office (GAO) released a report in late 2006 on the need for better communication of fees.

EBSA seeks input on fee disclosure

On April 25, 2007, the EBSA issued a Request for Information (RFI) on the disclosure of fees and expenses to participants in individual account plans. EBSA accepted feedback through July 24, 2007, giving interested parties three months to make their views known to the agency. The RFI contemplates a review of the ERISA rules governing this disclosure. EBSA will take this feedback to determine whether new rules are needed or whether current rules should be modified. The goal of the RFI is to ensure that participants and beneficiaries have the information they need to make informed decisions about managing their accounts and investing their retirement savings.

This is particularly important for those participants charged with handling their own investments, as in many defined contribution plans. The challenge then becomes one of figuring out what information should be provided, in what form, and who should provide the information. Many studies have found that participants get too confused when overwhelmed with information or too many choices.

Current regulations under ERISA section 404(c) relieve fiduciaries from liability when participants are presented with adequate and appropriate information on plan investment options, so that the participants can exercise control over the assets in their accounts. For the less-sophisticated investor, it is suggested that a summary of information would be more helpful than a detailed prospectus. These days there is considerable information available on the Internet. It is expected that this RFI will help determine whether participants already have what they need at their disposal, and whether information that is currently provided to taxpayers is done so in a user-friendly and beneficial manner.

The EBSA Request for Information can be read in its entirety in the April 25, 2007 edition of the U.S. Federal Register.

GAO examines plan fees

The U.S. Government Accountability Office (GAO) released a report in late 2006 that found that investment fees charged by mutual fund companies and other firms for the funds available in a plan comprise the bulk of the plan's fees. These fees are typically paid by participants. Next in line on the fee spectrum are recordkeeping fees, which are designed to cover the administrative costs of maintaining a plan. These are usually paid by plan sponsors, but participants are incurring these costs as well in many cases. According to the GAO, the fee information that plan sponsors are currently required to furnish to participants is limited in nature and done in a rather piecemeal fashion for plans in which individuals direct their own investments, making it much more challenging to compare investment options in a plan.

Authors of the GAO report were concerned that although the U.S. Department of Labor has the authority to oversee retirement plan fees and certain types of business arrangements, it lacks sufficient information to effectively monitor the activity. The GAO would like to see U.S. Department of Labor pay closer attention to fee arrangements entered into by retirement services providers and fund companies.

In fact, GAO recommends that Congress amend ERISA to require plan sponsors to disclose fee information to participants on each investment option in the plan, and to require that service providers disclose to plan sponsors any compensation they might receive from other service providers. GAO also recommends that plan sponsors be required to report to the U.S. Department of Labor a summary of all fees paid out of plan assets or by participants. The GAO report can be found at <http://www.gao.gov/new.items/d0721.pdf>.

U.S House Committee addresses fees

The House Education and Labor Committee, led by Rep. George Miller (D-CA), conducted hearings in March 2007 that addressed the question of whether hidden plan fees are undermining retirement security. The hearings were designed to examine whether current fee structures were adhering to ERISA's requirements that fees be reasonable and necessary. Rep. Miller expressed concern that fees such as revenue sharing, wrap fees, finders' fees, shelf space, surrender charges, soft dollars, and 12b-1 fees might be getting in the way of retirees achieving financial security. The hearing received widespread media coverage, as have the related issues.

Some have suggested that by maximizing these fees, service providers at the least are providing the opportunity for a conflict of interest that runs counter to acting in the best interest of participants. In fact, there has been a rash of lawsuits of late, including class actions against certain large employers. Others, however, point out that retirement plans are complicated by nature to offer and maintain, but employers are willing to incur the costs because offering a competitive compensation package may be crucial to retaining talented employees.

We have probably only heard the beginning of the discussion of the reasonableness and transparency of plan fees, particularly as we hear more about the approaching retirement of millions of Baby Boomers, many of whom have inadequate savings to last throughout their retirement years. The EBSA has produced an informative piece that provides a good overview of the costs associated with retirement plans. The publication, "Understanding Retirement Plan Fees and Expenses," is available online at <http://www.dol.gov/ebsa/pdf/undrstndgrtrmmt.pdf>.

In this **Briefing**, Florida TaxWatch has surveyed the current scene as it relates to plan fees. In the coming months, FTW will highlight other areas that will be of great interest to taxpayers, plan participants and policymakers, such as (1) where defined benefit plans are heading and best practices in meeting participant needs through defined contribution plans, (2) the impact on a plan sponsor if it is not proactive

in focusing on fees and other areas of fiduciary responsibility in managing its retirement plan, and (3) how to most effectively reach Florida's hard-working public employees so that they both feel and are truly empowered in wisely guiding how they direct and advance their retirement assets as well as their entire family's stability and well-being. Such improvements will greatly help Florida's government employees, participating state and local government agencies and all the hard-working taxpayers of Florida.

About Florida TaxWatch

Florida TaxWatch is a statewide, non-profit, non-partisan taxpayer research institute and government watchdog that over its 28-year history has become widely recognized as the watchdog of citizens' hard-earned tax dollars. Its mission is to provide the citizens of Florida and public officials with high quality, independent research and education on government revenues, expenditures, taxation, public policies, and programs, and to increase the productivity and accountability of Florida Government.

Florida TaxWatch's research recommends productivity enhancements and explains the statewide impact of economic and tax and spend policies and practices on citizens and businesses. Florida TaxWatch has worked diligently and effectively to help state government shape responsible fiscal and public policy that adds value and benefit to taxpayers.

This diligence has yielded impressive results: in its first two decades alone, policymakers and government employees implemented three-fourths of Florida TaxWatch's cost-saving recommendations, saving the taxpayers of Florida more than \$6.2 billion -- approximately \$1,067 in added value for every Florida family, according to an independent assessment by Florida State University.

Florida TaxWatch has a historical understanding of state government, public policy issues, and the battles fought in the past necessary to structure effective solutions for today and the future. It is the only statewide organization devoted entirely to Florida taxing and spending issues. Its research and recommendations are reported on regularly by the statewide news media.

Supported by voluntary, tax-deductible memberships and grants, Florida TaxWatch is open to any organization or individual interested in helping to make Florida competitive, healthy and economically prosperous by supporting a credible research effort that promotes constructive taxpayer improvements. Members, through their loyal support, help Florida TaxWatch bring about a more effective, responsive government that is accountable to the citizens it serves.

Florida TaxWatch is supported by all types of taxpayers -- homeowners, small businesses, large corporations, philanthropic foundations, professionals, associations, labor organizations, retirees -- simply stated, the taxpayers of Florida. The officers, Board of Trustees and members of Florida TaxWatch are respected leaders and citizens from across Florida, committed to improving the health and prosperity of Florida.

With your help, Florida TaxWatch will continue its diligence to make certain your tax investments are fair and beneficial to you, the taxpaying customer, who supports Florida's government. Florida TaxWatch is ever present to ensure that taxes are equitable, not excessive, that their public benefits and costs are weighed, and government agencies are more responsive and productive in the use of your hard-earned tax dollars.

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