Why GAO Did This Study

Recent volatility in financial markets highlights the need for prudent investment decisions if 401(k) plans are to provide an adequate source of retirement income. While plan sponsors and participants may receive help in assessing their investment choices, concerns have been raised about the impartiality of the advice provided. GAO was asked to describe circumstances where service providers may have conflicts of interest in providing assistance related to the selection of investment options. For example, if participants use their plan provider for Individual Retirement Accounts (IRAs), they may not understand, because of insufficient disclosure, that fees are often higher for products offered outside the plan. Account rollovers, they may not understand, because of insufficient disclosure, that fees are often higher for products offered outside the plan.

What GAO Recommends

GAO recommends that Labor amend regulations to require that service providers disclose compensation and fiduciary status in a consistent, summary format and revise current standards, which permit a service provider to highlight investment options in which it has a financial interest. GAO also recommends that the Department of the Treasury amend proposed regulations to require disclosure that investment products outside of plans to participants, a practice known as cross-selling. For example, if participants use their plan provider for Individual Retirement Account rollovers, they may not understand, because of insufficient disclosure, that fees are often higher for products offered outside the plan. In certain situations, participants face conflicts of interest from providers that have a financial interest when providing investment assistance. For example, although investment education is defined as generalized investment information, providers may highlight their own funds as examples of investments available within asset classes even though they may have a financial interest in the funds. According to industry experts, participants perceive education as investment advice. Thus, participants may not understand that the provider is not a fiduciary adviser required to act solely in participants’ best interests. Also, several industry experts expressed concerns that providers stand to gain higher profits from marketing investment products outside of plans to participants, a practice known as cross-selling. For example, if participants use their plan provider for Individual Retirement Account rollovers, they may not understand, because of insufficient disclosure, that fees are often higher for products offered outside the plan. Consequently, participants may choose funds that do not meet their needs and pay higher fees, which reduce their retirement savings.

What GAO Found

The sponsors of 401(k) plans face conflicts of interest from service providers assisting in the selection of investment options because of third-party payments and other business arrangements. For example, providers who help sponsors to establish and maintain their plans may receive third-party payments from investment fund companies. The payments, sometimes called revenue sharing, create a conflict of interest because the provider may receive greater compensation from certain funds. Moreover, providers are reported to commonly structure their relationships with sponsors in a manner that avoids being subject to fiduciary standards under the Employee Retirement Income Security Act (ERISA). According to several industry experts, many sponsors, particularly of smaller plans, do not understand whether or not providers to the plan are fiduciaries, nor are they aware that the provider’s compensation may vary based on the investment options selected. Such conflicts could lead to higher costs for the plan, which are typically borne by participants. In certain situations, participants face conflicts of interest from providers that have a financial interest when providing investment assistance. For example, although investment education is defined as generalized investment information, providers may highlight their own funds as examples of investments available within asset classes even though they may have a financial interest in the funds. According to industry experts, participants perceive education as investment advice. Thus, participants may not understand that the provider is not a fiduciary adviser required to act solely in participants’ best interests. Also, several industry experts expressed concerns that providers stand to gain higher profits from marketing investment products outside of plans to participants, a practice known as cross-selling. For example, if participants use their plan provider for Individual Retirement Account rollovers, they may not understand, because of insufficient disclosure, that fees are often higher for products offered outside the plan.