

April 2012

# 401(K) PLANS

## Increased Educational Outreach and Broader Oversight May Help Reduce Plan Fees



## Why GAO Did This Study

Studies have been conducted to better understand the fees 401(k) plan sponsors and their participants pay. However, these studies focus on larger plans. Thus, uncertainty remains about the amounts paid by small and medium-sized plans and the level of knowledge and expertise these sponsors have to assess the fees charged by service providers.

GAO addressed the following related to small, medium-sized, and large plans:

- (1) amounts plan sponsors and participants pay for services,
- (2) challenges sponsors face in understanding how fees are charged, and
- (3) actions Labor has taken to help sponsors better understand and monitor the fees charged by service providers.

GAO reviewed relevant federal laws, regulations, and retirement research, and interviewed federal officials and industry experts. GAO also conducted a survey of 1,000 401(k) plans to collect information about fees paid for plan services. The response rate allowed GAO to generalize to the population of 401(k) plans for most of the survey questions. The survey instrument and most results can be viewed at [GAO-12-550SP](#).

## What GAO Recommends

GAO recommends that Labor develop and implement more proactive approaches to sponsor educational outreach, improve public access to annual Form 5500 data, and examine the definition of a fiduciary to determine if it captures the current relationship between sponsors and providers. In response, Labor generally agreed with the findings and will explore ways to implement these recommendations.

View [GAO-12-325](#). To view the e-supplement online, click on [GAO-12-550SP](#). For more information, contact Charlie Jeszeck at (202) 512-7215 or [jeszeckc@gao.gov](mailto:jeszeckc@gao.gov).

## 401(K) PLANS

### Increased Educational Outreach and Broader Oversight May Help Reduce Plan Fees

## What GAO Found

Plan sponsors and participants paid a range of fees for services, though smaller plans typically paid higher fees as a percentage of plan assets. For example, the average amount sponsors of small plans reported paying for recordkeeping and administrative services was 1.33 percent of assets annually, compared with 0.15 percent paid by sponsors of large plans. Larger plans were more likely to pass recordkeeping fees along to participants, but when fees were passed along to participants in small plans, those in large plans paid lower fees than those in small plans. Participants also paid for investment and plan consulting fees—through fees deducted from their plan assets—in more instances than sponsors.

GAO's survey and review of plan documents showed that some sponsors faced challenges in understanding the fees they and their participants were charged. Some sponsors did not know if their providers used complex fee arrangements, such as revenue sharing, or if their plans paid certain fees under an insurance contract, such as a group annuity contract. In addition, some sponsors reported knowing about arrangements, but did not fully understand how these fees were charged. For example, one relatively large plan underestimated recordkeeping fees by more than \$58,000, because the sponsor did not include the fees charged to participants' accounts under its revenue sharing arrangement.

### Revenue Sharing Example: Sponsor Awareness of Third-Party Payments to Their Providers for Services

Revenue sharing generally refers to indirect payments made from one service provider to another service provider in connection with services provided to the plan, rather than payments made directly by the plan sponsor for plan services. If sponsors do not understand these arrangements, it could result in the plan sponsor and participants paying more for services as assets grow, although the level of service provided tends to remain the same. A short video illustrating a hypothetical example of how revenue sharing arrangements can work is available at [http://www.gao.gov/multimedia/video/#video\\_id=590296](http://www.gao.gov/multimedia/video/#video_id=590296).

The Department of Labor (Labor) has taken several actions to help sponsors understand and monitor fees charged by service providers. For example, Labor disseminates a number of publications and resources, including a 401(k) fees checklist that is available to sponsors on its website to help them better understand plan fees. However, according to GAO's survey results, more than an estimated 90 percent of sponsors either did not know about or have not used Labor's resources to compare and assess plan fees. Additionally, sponsors have access to the plan information of others, including some fees paid, through the Form 5500, but GAO's survey also shows that the information is not being used by sponsors. Finally, although Labor has recently taken on regulatory initiatives to enhance fee disclosures to sponsors, their effect remains to be seen. For example, Labor is in the process of revising a proposed change to the definition of the term "fiduciary," which may allow Labor to oversee a broader range of plan investment advisers. However, Labor's authority over other types of providers, who have considerable influence over sponsors and may charge sponsors and their plan participants excessive fees, is limited.

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# Contents

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Letter		1
	Background	5
	Sponsors and Participants Paid a Range of Fees, though Smaller Plans Paid Higher Fees than Larger Plans	13
	Plan Sponsors Were Challenged by Complex Fee Arrangements and Likely Paid More than They Realized	24
	Labor Has Taken Actions to Help Sponsors, but Additional Efforts Are Needed to Effectively Oversee Fees Charged by Service Providers	37
	Conclusions	48
	Recommendations for Executive Action	49
	Agency Comments and Our Evaluation	50
Appendix I	Objectives, Scope, and Methodology	54
Appendix II	Identification of 401(k) Universe and Assessment of Form 5500 Data	61
Appendix III	Comments from the Department of Labor	64
Appendix IV	GAO Contacts and Staff Acknowledgments	69
Tables		
	Table 1: Summary of Labor’s Disclosure Initiatives	12
	Table 2: Estimated Percentage of 401(k) Plan Sponsors Who Asked Their Providers about Certain Fees	19
	Table 3: Description of Key Publications Related to 401(k) Plan Fees on the Department of Labor’s Website	38
	Table 4: Key Obstacles to Using Form 5500 Data to Assess 401(k) Plan Fees	43
	Table 5: 401(k) Plan Survey Sample and Response Rates	57
	Table 6: 401(k) Plan Characteristics, 2009	63

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## Figures

Figure 1: Structure of Service Provider Arrangements in 401(k) Plans	8
Figure 2: Responses Regarding whether Recordkeeping and Administrative Fees Were Paid for Calendar Year 2010	14
Figure 3: Among Respondents Who Provided Fee Information, the Average Fee Amounts as a Percentage of Assets Paid by Sponsors for Recordkeeping and Administrative Services, by Plan Size, 2010	16
Figure 4: Percentage of Respondents Who Reported Asking Their Providers about 12b-1 and Wrap Fees and Paid These Fees	20
Figure 5: Among Respondents Who Provided Amounts, the Percentage of Investment Management Fees by Participants, Sponsors, or Both, 2010	23
Figure 6: Estimated Percentage of 401(k) Plans with Revenue Sharing Arrangements as Reported by Plan Sponsors	25
Figure 7: Difference between Actual Recordkeeping Fees Paid by One Plan in 2010 and Those Reported by the Plan Sponsor under a Revenue Sharing Arrangement	28
Figure 8: A Hypothetical Example of Two Different 401(k) Investment Options with Similar Names	30
Figure 9: A Hypothetical Comparison of 401(k) Plans with and without Group Annuity Contracts	32
Figure 10: Percentage of Sponsors Who Reported That Transaction Costs Were Charged in 2010	35
Figure 11: Estimated 401(k) Plan Sponsors' Use of Labor's Educational Resources to Compare and Assess Fees	40
Figure 12: Estimated 401(k) Plan Sponsors' Use of Form 5500 Data to Compare and Assess Fees for Select Services	42
Figure 13: Examples of Activities Performed by Some Service Providers That May or May Not Be Considered ERISA Fiduciaries and Labor's Role with Respect to These Service Providers	47

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## Abbreviations

EBSA	Employee Benefits Security Administration
EFAST2	ERISA Filing Acceptance System 2
EIN	Employer Identification Number
ERISA	Employee Retirement Income Security Act of 1974
IRS	Internal Revenue Service
SEC	Securities and Exchange Commission
Sub-TA	Sub-transfer agent

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United States Government Accountability Office  
Washington, DC 20548

April 24, 2012

The Honorable George Miller  
Ranking Member  
Committee on Education and the  
Workforce  
House of Representatives

The Honorable Robert E. Andrews  
Ranking Member  
Subcommittee on Health, Employment,  
Labor, and Pensions  
Committee on Education and the  
Workforce  
House of Representatives

As American workers have increasingly come to rely on their 401(k) plans for retirement income, policymakers have focused their attention on the fees charged to the plan sponsor—typically the employer offering the plan—and plan participants.<sup>1</sup> Our past work has shown that the amount of plan fees paid by participants can significantly reduce retirement savings and is dependent on several factors, including the decisions made by the plan sponsor to hire service providers—outside entities to help administer their plans.<sup>2</sup> Studies have also been conducted by industry organizations to better understand the decisions plan sponsors make in managing their 401(k) plans. However, these studies are generally based on surveys of larger plans—those with more than 500 participants—and most have not specifically focused on the fees charged by plan service providers. As a result, uncertainty remains about the fees paid by small and medium-size plans, which account for the majority of all 401(k) plans, and about the

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<sup>1</sup>For the purposes of this report, we refer to plan sponsors as the employers sponsoring 401(k) plans, who are typically plan fiduciaries.

<sup>2</sup>A plan sponsor may hire outside companies to provide a number of key services to the plan. Services provided by these outside companies typically include recordkeeping (i.e., tracking individual account contributions), investment management (i.e., selecting and managing the securities included in a mutual fund), consulting and investment advice (i.e., selecting vendors for investment options), custodial or trustee services for plan assets (i.e., holding other plan assets in a bank), and telephone or web-based customer services for participants.

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level of knowledge and expertise sponsors of these plans have to determine the fees charged by service providers. Consequently, you asked us to survey sponsors of small, medium-size, and large plans with different characteristics, such as total plan assets, geographic distribution, and nature of business, to collect information on the following:

1. How much do plan sponsors and participants pay for services performed by service providers?
2. What, if any, challenges do sponsors face in understanding how fees are charged to their plan?
3. What actions has the Department of Labor (Labor) taken to help plan sponsors understand and monitor fees charged by service providers?

To answer these questions, we reviewed relevant federal laws and regulations pertaining to 401(k) fees and fee disclosure. We also reviewed research and available guidance provided to plan sponsors by Labor and the Securities and Exchange Commission (SEC), and industry research related to understanding and disclosing fee information. We interviewed Labor, SEC, and Internal Revenue Service (IRS) officials; industry experts; plan sponsors; and service providers about factors that affect the amount of 401(k) fees that can be charged to sponsors and participants as well as current and proposed regulations and the requirements governing the disclosure of fee information.

To obtain information about the fees sponsors pay for services performed by providers, the factors they considered in selecting service providers, and Labor resources they may have used during calendar year 2010, we conducted a representative survey of 401(k) plan sponsors.<sup>3</sup> We drew a stratified random sample of 1,000 plan sponsors from a population of 468,194 unique 401(k) plans from 2009 Form 5500 Annual Return/Report filings (Form 5500).<sup>4</sup> The sample was stratified by the number of

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<sup>3</sup>This report does not attempt to report on all plan fees for all plans in our sample, because some fees associated with operating 401(k) plans may be less apparent to plan sponsors.

<sup>4</sup>The Form 5500 Annual Return/Report of Employee Benefit Plan is the primary source of information for the federal agencies administering Employee Retirement Income Security Act of 1974 (ERISA) and the private sector regarding the operation, funding, assets, and investments of private pension plans and other employee benefit plans. Labor, IRS, and the Pension Benefit Guaranty Corporation jointly developed the Form 5500 so employee benefit plans could satisfy annual financial reporting requirements under ERISA and the Internal Revenue Code.

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participants reported at the beginning of plan year 2009 into five groups: fewer than 10 participants, 10-49 participants, 50-99 participants, 100-499 participants, or 500-plus participants. This stratification emphasized smaller plans because the vast majority of plans in the 401(k) plans universe have fewer than 500 participants. Although our sample was grouped into five strata, for the purposes of comparison and to help increase the statistical power of our estimates, we analyzed survey results by three groups: fewer than 50 participants, 50 to 499, and more than 500. Our survey yielded a weighted response rate of about 39 percent. We conducted a nonresponse bias analysis to see if the characteristics of survey respondents generally reflected population characteristics, such as plan size (i.e., the total number of participants), total plan assets, geographic distribution, and nature of business. The results of our nonresponse bias analysis enable us to generalize our results to the total population of 401(k) plan sponsors for most survey questions.<sup>5</sup> We make note of instances in which survey responses are not generalizable. To encourage survey participation, we obtained permission from our congressional requesters to remove links in our paperwork between individuals' identities and their responses. We informed sponsors of this agreement in the introductory letter transmitted with the survey. A detailed description of our sampling methodology can be found in appendix I. The survey instrument and a more complete tabulation of the results can be viewed at [GAO-12-550SP](#).

As part of our analysis of fees for recordkeeping and administrative services; investment management; retirement plan consulting; and other fees, such as legal or trustee fees, we generated estimates of the amounts paid by sponsors and participants. Although all of our fee estimates are not generalizable to the population of 401(k) plan sponsors, we feel they are illustrative of the amounts paid by sponsors and participants. We calculated our estimates as a percentage of plan assets and on a per participant basis using the annual amounts reported by sponsors for each service, plan assets, and number of plan participants for calendar year 2010. To supplement our analysis of the fee amounts sponsors reported paying and their understanding of how fees are charged to plans, we also analyzed documents, such as investment reports, that sponsors submitted with their survey responses. We also

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<sup>5</sup>All percentage estimates from the survey have margins of error at the 95 percent confidence level of plus or minus 8 percentage points or less, unless otherwise noted.



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reviewed investment fund prospectuses associated with the investment options included in the documents sponsors submitted<sup>6</sup> to determine whether plans paid certain fees.<sup>7</sup> Finally, for respondents for whom data were available, we reviewed fee reports generated by a third party, BrightScope, to determine the estimated fees associated with transaction costs for individual investment options. BrightScope estimates fee amounts of 401(k) plan fees by drawing on publicly available data, primarily Form 5500 filings, which include independently audited information.<sup>8</sup> We took actions to determine whether the BrightScope data were sufficiently reliable for our purpose of describing the range of transaction costs incurred by 401(k) plan participants by interviewing company representatives and reviewing the methodology used to develop estimates.

We conducted this performance audit from October 2010 through April 2012 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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<sup>6</sup>Presently, funds must provide investors with written disclosures about the fund in a prospectus that must be provided to investors when they purchase shares. According to SEC, under federal securities laws, a fund can satisfy its prospectus delivery obligation by providing its prospectus to the plan (without having to provide the prospectus to participants). SEC rules require that the prospectus include a fee table containing information about the sales charges, operating expenses, and other fees that investors pay as part of investing in the fund.

<sup>7</sup>In conducting a review of fees and analysis of supplemental documents, it was not the purpose, nor does GAO purport, to identify situations or circumstances in this report where plan sponsors or fiduciaries may have breached their fiduciary duties. Determining whether a fiduciary breach has occurred is based upon the facts and circumstances of each case. Our follow-up with plan sponsors was not aimed at reaching this determination. Therefore, our findings should not be read as indicating a breach of fiduciary or other obligation.

<sup>8</sup>BrightScope is a financial information company that services U.S. plan sponsors, advisers, providers, and participants. BrightScope maintains a database of information on 401(k) plans, which it uses to quantitatively rate plans across a number of metrics, including total plan fees, quality of investment menu options, and plan participation. BrightScope used publicly available data from various sources, including Form 5500 filings, the SEC, the U.S. Census Bureau, and the Bureau of Labor Statistics, to help develop and maintain its database.

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## Background

Under Title I of the Employee Retirement Income Security Act of 1974 (ERISA), employers are permitted to sponsor two broad types of retirement plans, defined benefit—plans that promise to provide a benefit that is generally based on an employee’s years of service and frequently salary, regardless of the investment portfolio’s performance—or defined contribution—plans in which retirement savings are based on contributions and the performance of the investments in individual accounts. Over the last three decades, employers have shifted away from sponsoring defined benefit plans and toward defined contribution plans. The 401(k) plan is the predominant type of defined contribution plan in the United States. In 2009, employers sponsored over 460,000 401(k) plans with participation from over 60 million workers.<sup>9</sup> The assets held in these plans totaled more than \$2.4 trillion.

Typically, 401(k) plans allow participants to specify the size of their contributions and direct their assets to one or more investments among the options offered within the plan. Investment choices within the plan generally include options such as mutual funds, target date funds, stable value funds, company stock, money market funds, and self-directed brokerage accounts. Industry research shows that as of the end of 2009, participants had allocated about 41 percent of 401(k) plan assets to equity funds, a type of mutual fund that mainly invests in stocks, followed by a mix of other investments, including company stock and stable value funds—funds that are designed to preserve the total amount of participants’ contributions, or their principal, while also providing steady positive returns.<sup>10</sup> When deciding how to allocate assets among the various investment options, participants are generally advised to consider a number of factors, such as historical performance, investment risk, and fees associated with each option. As we previously reported, even a seemingly small fee, such as a 1 percent annual charge, can significantly reduce retirement savings over the course of a career.<sup>11</sup>

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<sup>9</sup>These estimates are based on GAO analysis of plan year 2009 Form 5500 filings. For details about our estimates, see appendix II.

<sup>10</sup>Employee Benefit Research Institute, *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2009* (Washington, D.C.: November 2010).

<sup>11</sup>GAO, *Private Pensions: Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information on Fees*, [GAO-07-21](#) (Washington, D.C.: Nov. 16, 2006).

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## Fiduciary Obligations under ERISA

Under ERISA, a fiduciary is anyone who has discretionary control or authority over the management or administration of an ERISA-covered plan, such as a 401(k) plan, including the plan's assets.<sup>12</sup> Plan sponsors are typically the named fiduciaries, but others, such as trustees, investment advisers, or other service providers, may also be fiduciaries depending on the functions they perform for the plan.

Plan sponsors and other plan fiduciaries have specific responsibilities under ERISA. For example, ERISA stipulates that plan fiduciaries carry out their responsibilities prudently and do so solely in the interest of the plan's participants and beneficiaries.<sup>13</sup> In accordance with ERISA and related Labor regulations and guidance, responsibilities of plan sponsors and other fiduciaries may include, but are not limited to,

- selecting and monitoring any service providers to the plan;
- reporting plan information to the federal government and to participants;
- adhering to the plan documents, including any investment policy statements;
- identifying parties-in-interest to the plan and taking steps to monitor transactions with them;
- selecting and monitoring investment options the plan will offer and diversifying plan investments; and
- ensuring that the services provided to their plans are necessary and that the cost of those services is reasonable.

On October 22, 2010, Labor proposed regulations that would amend the definition of an ERISA fiduciary with respect to providing investment

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<sup>12</sup>Under section 3(21)(A), a fiduciary is anyone who exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets or renders investment advice for a fee or compensation, direct or indirect, with respect to any moneys or other property of such plan, or has authority to do so, or has any discretionary authority or discretionary responsibility in the administration of the plan.

<sup>13</sup>29 U.S.C §1104(a)(2).

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advice for a fee.<sup>14</sup> After obtaining written comments from the public and holding two public hearings on the proposed regulation, Labor announced it will repropose its rule on the definition of a fiduciary in early 2012.<sup>15</sup>

Labor's Employee Benefits Security Administration (EBSA) is the primary agency responsible for protecting private pension plan participants from the misuse or theft of their pension assets by enforcing ERISA. To carry out its responsibilities, EBSA issues regulations and guidance, conducts investigations of plan fiduciaries and service providers, seeks appropriate remedies to correct violations of the law, and pursues litigation when it deems that necessary.

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## Key 401(k) Plan Services and Fees

Plan sponsors may hire companies that will provide the services necessary to operate their 401(k) plans. Service providers are outside entities, such as investment companies, banks, or insurance companies that a plan sponsor hires to provide some of the services necessary to operate the plan. These services include

- investment management (e.g., selecting and managing the securities included in a mutual fund),
- consulting and providing financial advice (e.g., selecting vendors for investment options or other services),
- recordkeeping (e.g., tracking individual account contributions),
- custodial or trustee services for plan assets (e.g., holding the plan assets in a bank), and
- telephone or web-based customer services for participants.

As shown in figure 1, services can be provided by a single “bundled” plan service provider or through contracts with a combination of several different entities—also known as an “unbundled” arrangement. In a bundled arrangement, the sponsor hires one company that provides the

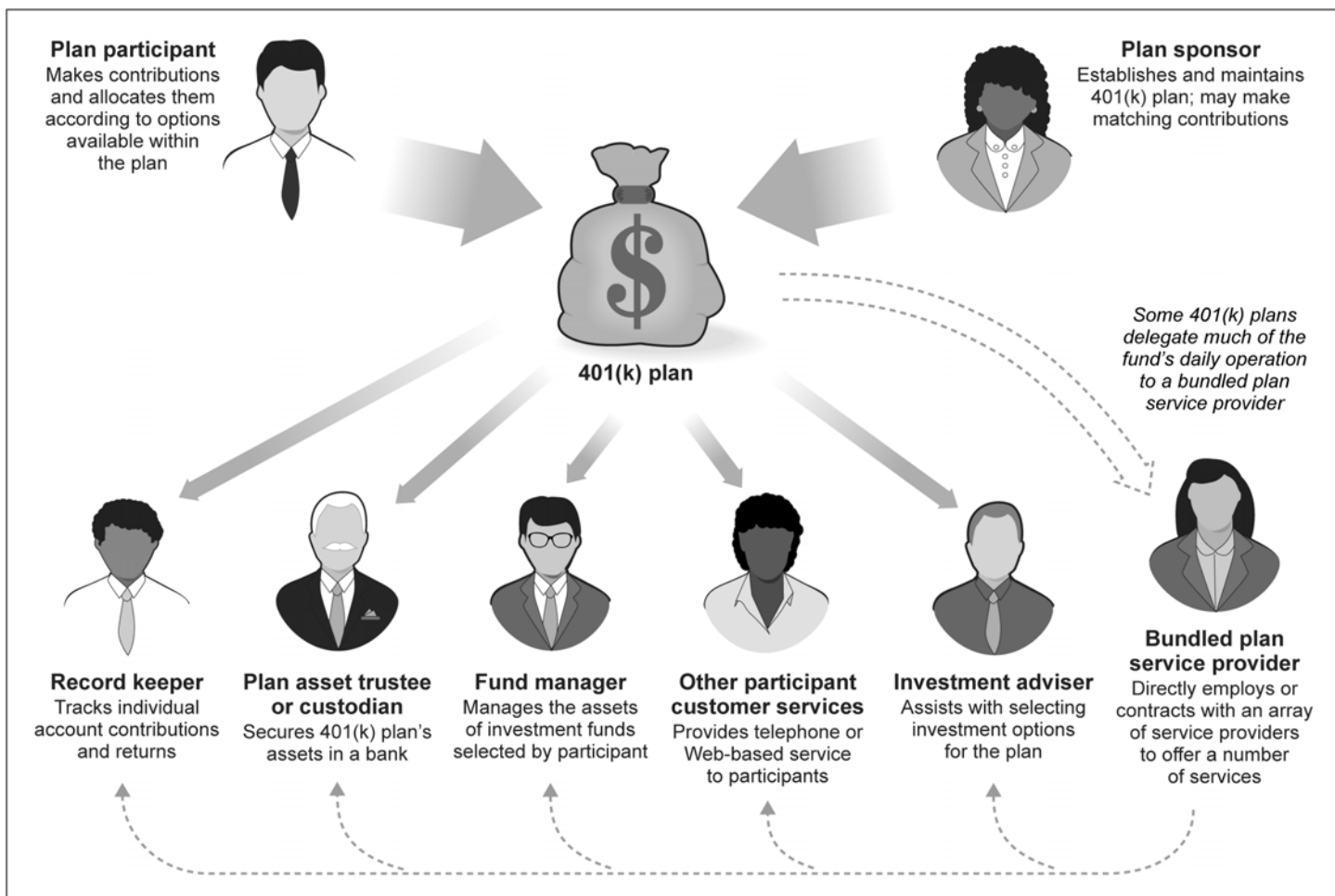
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<sup>14</sup>Definition of the Term “Fiduciary,” 75 Fed. Reg. 65,263 (Oct. 22, 2010)(to be codified at 29 C.F.R. pt. 2510).

<sup>15</sup>EBSA News Release No. 11-1382-NAT, Sept. 19, 2011.

full range of services directly or through subcontracts with other providers. Using a bundled provider, the sponsor might also delegate the oversight for the selection and monitoring of plan services, except with respect to the bundled provider itself. In contrast, in an unbundled arrangement, the sponsor, acting in a fiduciary capacity, selects each service provider and retains an ongoing duty to monitor service providers.

**Figure 1: Structure of Service Provider Arrangements in 401(k) Plans**



Source: GAO analysis of information from industry practitioners.

Service providers can be compensated for their services either directly from the plan sponsor or indirectly—payments from sources other than the plan or plan sponsor. Typically, service provider compensation comes in the form of fees charged as a percentage of total plan assets, per

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participant, an itemized fixed rate, or a combination of all three. How fees are assessed largely depends on the type of service provided and the plan sponsor. For example, fees for investment management services, which can vary by investment option, are generally charged as a percentage of assets and indirectly charged against participants' accounts, because they are deducted directly from investment returns. Administrative fees, on the other hand, can be assessed as an overall percentage of total plan assets regardless of participants' investment choices, in addition to a flat rate for some fixed services, such as the printing of plan documents. In the latter, the sponsor has the option of passing along some or all of the administrative fees to participants. We previously reported that recordkeeping and administrative fees are often paid by the plan sponsors, but participants bear them in a growing number of plans.<sup>16</sup>

Service providers charge an array of fees depending on the type of product and arrangement the provider may have with other entities that provide plan services. Some common investment-related fees are the following:

- **Management fees:** These fees are paid out of fund assets to the fund's investment adviser for investment portfolio management, other management fees payable to the fund's investment adviser or its affiliates, and administrative fees payable to the investment adviser that may not be included in some of the fees identified below.
- **Marketing and distribution fees, also known as 12b-1 fees:** These fees may be used to pay commissions to brokers and other salespersons, to pay for advertising and other costs of promoting the fund to investors, and to pay various service providers of a 401(k) plan pursuant to a bundled services arrangement. They are usually between 0.25 percent and 1.00 percent of assets annually.
- **Sub-transfer agent (sub-TA) fees:** These fees are typically used to reimburse a plan's record keeper for shareholder services that the fund would have otherwise provided, such as maintaining participant-level accounts and distributing the fund's prospectus.

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<sup>16</sup>GAO-07-21.

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- **Trading or transaction costs:** These fees are associated with an investment manager's buying and selling of securities within a particular investment vehicle, such as a mutual fund, which can include commissions. These also include costs associated with portfolio turnover.
  - **Wrap fees:** These fees are usually associated with insurance products, such as group variable annuities.<sup>17</sup> They are aggregate fees that encompass multiple components, such as investment management fees, mortality risk and administrative expense charges, and surrender and transfer charges.<sup>18</sup>

Some of these fees may be paid by third parties in connection with investment-related services, also known as revenue sharing, which are ultimately indirectly paid for by the plan or its participants.

#### **Description of Revenue Sharing Arrangements**

Revenue sharing, in the 401(k) plan industry, generally refers to indirect payments made from one service provider, such as the investment fund provider, to another service provider in connection with services provided to the plan, rather than payments made directly by the plan sponsor for plan services. For example, a plan's record keeper and investment fund manager may have an arrangement where the investment fund company collects sub-TA fees from plan assets invested in a particular fund that may then be used as a credit to offset the record keeper's fees.

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<sup>17</sup>Group variable annuities are insurance products that place a wrapper of benefits, namely a guaranteed lifetime annuity income or a minimum death benefit, around a bundle of investments that are similar to mutual funds.

<sup>18</sup>Mortality risk and administrative expense fees are charged by insurance companies to cover the cost of the insurance features of an annuity contract, including the guarantee of a lifetime income payment interest and expense guarantees, and any death benefit provided during the accumulation period. Surrender and transfer charges are fees an insurance company may charge when an employer terminates a contract before the term of the contract expires or when a participant withdraws an amount from the contract. These charges may be imposed if these events occur before the expiration of a stated period and commonly decrease and disappear over time.

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## Form 5500 Annual Return/Report

The Form 5500 Annual Return/Report is the primary source of information for the federal agencies administering ERISA and the private sector regarding the operation, funding, assets, and investments of private pension plans and other employee benefit plans.<sup>19</sup> Labor, IRS, and the Pension Benefit Guaranty Corporation jointly developed the Form 5500 so employee benefit plans could satisfy annual financial reporting requirements under ERISA and the Internal Revenue Code. Specifically, Labor uses the Form 5500, among other mechanisms, as a tool to monitor and enforce plan sponsors' responsibilities under ERISA.

The Form 5500 includes information on the plan's sponsor, the number of participants, plan service providers, and more specific financial information, such as plan assets, liabilities, insurance, and financial transactions. According to Labor officials, the form is made publicly available to serve as a deterrent to noncompliance with the statutory duties imposed on plan fiduciaries. A research file is also available in electronic format to individuals and groups for research purposes.<sup>20</sup>

In November 2007, Labor implemented new regulations to expand fee and compensation disclosures on the Form 5500.<sup>21</sup> Specifically, for the 2009 plan year, Labor revised the annual reporting requirements concerning service providers and to facilitate electronic filing. Labor required larger plan sponsors—mainly those with more than 100 plan participants—to classify the fees they pay service providers as either “direct” or “indirect” compensation in an updated Form 5500 Schedule C—Service Provider Information.

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<sup>19</sup>For the purposes of this report, we will be discussing Form 5500 reports as they relate to private pension plans.

<sup>20</sup>The Form 5500 Private Pension Plan Research Files are created each year to support creation of Labor's *Private Pension Plan Bulletins*. They include Form 5500 filings from all private pension plans having 100 or more participants and a 5 percent sample of smaller private pension plans. The private pension plan research files correct many statistically important logical and arithmetic data inconsistencies that remain after completion of processing. For the research file, a user's guide with information on the construction of, structure of, and variables included in the file is made available. In addition, separate from the research file, an electronic database of unedited filings for each plan year is publicly available on Labor's website and in response to Freedom of Information Act requests.

<sup>21</sup>Annual Reporting and Disclosure, 72 Fed. Reg. 64,710 (Nov. 16, 2007)(to codified at 29 C.F.R. pt. 2520).



## Labor's Recent Regulatory Actions Regarding Fee Disclosure

Labor's more recent regulatory initiatives focus on enhanced disclosure to plan fiduciaries and plan participants; see table 1 for a description of these initiatives. These regulations, as well as changes to the Form 5500 and its instructions, enhance the disclosure of plan financial information related to fees and other arrangements involving plan fiduciaries and participants.

**Table 1: Summary of Labor's Disclosure Initiatives**

<p><b>Final rule</b> Reasonable Contract or Arrangement Under Section 408(b)(2)–Fee Disclosure, 77 Fed. Reg. 5632 (Feb. 3, 2012)(to be codified at 29 C.F.R. pt. 2550)</p>	<p>On February 3, 2012, Labor finalized a rule concerning the disclosures that must be furnished to plan fiduciaries, including plan sponsors, in order for a contract or arrangement for plan services to be “reasonable,” as required by ERISA section 408(b)(2). Specifically, the final rule requires that disclosures be provided to a responsible plan fiduciary in writing to assist plan fiduciaries in assessing the reasonableness of the compensation paid for services and the conflicts of interests that may affect a service provider’s performance.</p>
<p><b>Final rule</b> Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans, 75 Fed. Reg. 64,910 (Oct. 20, 2010)(to be codified at 29 C.F.R. pt. 2550)</p>	<p>Labor finalized a regulation that requires the disclosure of certain plan and investment-related information, including fee and expense information, to participants and beneficiaries in participant-directed individual account plans.</p>
<p><b>Proposed rule</b> Definition of the Term “Fiduciary,” 75 Fed. Reg. 65,263 (Oct. 22, 2010)(to be codified at 29 C.F.R. pt. 2510)</p>	<p>On October 22, 2010, Labor proposed a regulation, which more broadly defines the circumstances under which a person is considered to be a fiduciary by reason of giving investment advice to a plan or a plan’s participants. Labor has indicated that it intends to repropose this definition in early 2012, see EBSA News Release No. 11-1382-NAT, Sept. 19, 2011.</p>

Source: GAO analysis of Labor regulations.

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## Sponsors and Participants Paid a Range of Fees, though Smaller Plans Paid Higher Fees than Larger Plans

### Industry Studies on 401(k) Plan Fees

Pension industry studies and surveys of 401(k) plans focusing on fees have found that plans pay a range in fees. For example, BrightScope recently estimated that the average fees paid by plans with less than \$10 million in assets for all recordkeeping, advice, and investment management services was 1.90 percent and 1.08 percent for plans with over \$100 million in assets. However, BrightScope's estimates do not include plans with fewer than 100 participants, which account for about 88 percent of all 401(k) plans. Another study conducted in 2011, which included plans of all sizes, estimated that the average total amount paid in defined contribution plans for recordkeeping, administrative, and investment fees was approximately 1.30 percent.

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## Sponsors Paid Recordkeeping and Administrative and Other Fees, but Small Plans Typically Paid Higher Amounts and More of the Fees

### Recordkeeping and Administrative Fees Paid by Sponsors

Eighty-five percent of sponsors reported that they or their participants paid recordkeeping and administrative fees, as shown in figure 2.<sup>22</sup> Of the respondents who reported paying fees, over three-quarters were small plans, close to 20 percent were medium-sized plans, and the remainder were large plans.<sup>23</sup> In addition to sponsors who said their plans paid

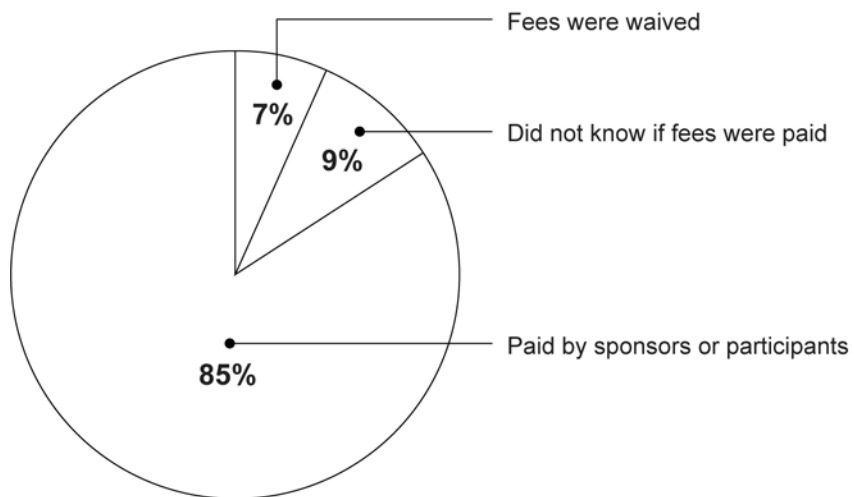
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<sup>22</sup>We use the word "reported" in this document to make clear that this is information given or gathered from survey responses and follow-up. Because these data were collected by a survey methodology, they are subject to nonsampling error and are based on respondent interpretation of survey question wording. We took actions to reduce nonsampling error. For example, we conducted integrity checks of answers across questions and enforced skip patterns, when appropriate.

<sup>23</sup>Given there is no industry wide definition of "small," "medium," and "large" plans, for the purposes of this report, we defined small plans as those with fewer than 50 participants; medium-sized plans as those with 50 to 499 participants; and large as those with 500 or more participants. While we analyzed and report fees as a percentage of assets, we did not use plan assets as a proxy for plan size.

recordkeeping and administrative fees, sponsors of 9 percent of plans did not know if they or their participants paid for these services, and 7 percent reported fees were waived by their service providers.<sup>24</sup>

**Figure 2: Responses Regarding whether Recordkeeping and Administrative Fees Were Paid for Calendar Year 2010**



Source: GAO analysis of Survey of 401(k) Plan Sponsors.

Note: Percentages may not total to 100 because of rounding.

Of the sponsors who said either they or their participants paid fees and provided fee amounts, the range in fees reported as paid by plan sponsors for recordkeeping and administrative services was between 0.01 percent and 37.26 percent of plan assets annually.<sup>25</sup> We calculated

<sup>24</sup>Recordkeeping and administrative fees for plans reporting that these fees were waived may in fact have been paid by participants without the sponsor's knowledge. In a previous report, we noted that some funds are marketed to sponsors as having no fees, when in fact the record keepers are compensated out of the investment funds' operating expenses for their services, which is ultimately deducted from participants' accounts. See [GAO-07-21](#) for additional details.

<sup>25</sup>Sponsors reported fees paid during calendar year 2010 in absolute dollar amounts. Throughout this report, we report our fee estimates, which converted the absolute dollar amounts plan sponsors reported paying for each service, to amounts paid as a percentage of plan assets. For additional information on our methods, see appendix I.

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that sponsors paid an average of less than 1.77 percent of assets.<sup>26</sup> However, as shown in figure 3, the average amount paid for by sponsors of small plans (fewer than 50 participants) was 1.33 percent of assets.<sup>27</sup> In contrast, sponsors of larger plans—those with more than 500 participants—paid an average of 0.15 percent of assets.<sup>28</sup> According to industry experts and research, plans with fewer participants generally have lower plan assets, and therefore pay higher fees as a percentage of assets than plans with more assets or older plans that have grown their assets over the years. For example, the respondent in our survey that paid the highest amount, 37.26 percent of plan assets, for recordkeeping and administrative service fees started the plan in 2009 and had less than \$1,350 in plan assets at the end of calendar year 2010. Service providers and an industry expert we met with noted that administrative fees to start a 401(k) plan can be significant for small plans.<sup>29</sup> Additionally, representatives of a retirement industry organization said that it may be difficult for sponsors of small plans to negotiate for lower fees, because assets in these plans are modest.

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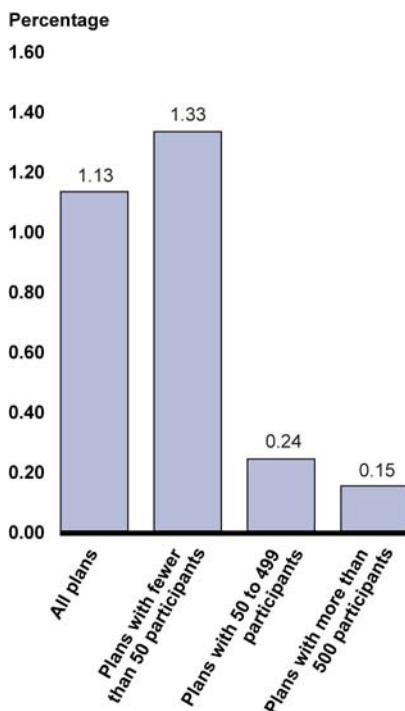
<sup>26</sup>Fee ranges for recordkeeping and administrative fees are generalizable to the population of 401(k) plans. Of the plans sampled, we obtained fee information from 243 respondents. We determined the response rate for this question was large enough for us to provide reliable estimates that could be generalized to the population of 401(k) plans.

<sup>27</sup>The 95 percent confidence interval for this estimate is between 0.55 and 2.11.

<sup>28</sup>The 95 percent confidence interval for this estimate, 0.15, is between 0.08 and 0.22.

<sup>29</sup>We also recently reported that sponsors of small plans found the startup and administrative requirements for retirement plans were burdensome. GAO, *Private Pensions: Better Agency Coordination Could Help Small Employers Address Challenges to Plan Sponsorship*, [GAO-12-326](#) (Washington, D.C.: Mar. 5, 2012).

**Figure 3: Among Respondents Who Provided Fee Information, the Average Fee Amounts as a Percentage of Assets Paid by Sponsors for Recordkeeping and Administrative Services, by Plan Size, 2010**



Source: GAO analysis of Survey of 401(k) Plan Sponsors.

Note: Our response rate for subgroups regarding recordkeeping and administrative fees was sufficient for us to make statements generalizable to the population of 401(k) plans. The 95 percent confidence intervals for the averages reported in the figure are 0.49 to 1.77 for all plans; 0.55 to 2.11 for plans with fewer than 50 participants; 0.17 to 0.31 for plans with 50 to 499 participants; and 0.08 to 0.22 for plans with more than 500 participants.

Larger plans are more likely to pass recordkeeping and administrative fees along to participants than smaller plans. Of the sponsors that provided fees, sponsors of 80 percent of plans reported paying for all the fees associated with recordkeeping and administrative services. However, sponsors of only 47 percent of large plans paid for recordkeeping and administrative services, while at least 82 percent of smaller plans paid these fees.<sup>30</sup> Thirty-two percent of the larger plans also

<sup>30</sup> Estimates in this statement have margins of error that are less than plus or minus 20 percentage points.

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reported passing along all of these fees to participants, and 22 percent shared these fees with participants.<sup>31</sup> Representatives from one industry organization we interviewed said that as plans get larger, they tend to pass more of the fees on to participants. However, the reason small plans paid these fees varied. For example, one sponsor of a small plan told us that it feels responsible for its employees and, as a result, chooses to pay the fees. And since sponsors of small plans could also be the business owners, consultants from one company pointed out these sponsors may be more personally interested in the plan.

#### Other Administrative Fees Paid by Sponsors

Twenty-one percent of sponsors reported that either they or their participants paid for other services such as trustee, legal, or audit services covering plans of all sizes. In addition, sponsors of about 22 percent of plans reported that their service providers waived these fees or that they did not pay anything for these types of services, while 29 percent of plan sponsors did not know if their plans paid these fees. The vast majority of respondents who did not know if fees were paid for these other services sponsored small plans, those with fewer than 50 participants.<sup>32</sup>

Of sponsors who reported they paid for other fees, a majority, 85 percent, reported they paid all of the fees for other services.<sup>33</sup> Most of the respondents reported paying less than 0.24 percent of plan assets annually for these services.<sup>34</sup> However, a couple of respondents of small and medium-sized plans paid more than 1 percent.

#### Investment Management Fees Paid by Sponsors

Even though investment management fees account for the majority of 401(k) plan fees, sponsors of about 50 percent of plans did not know if they or their participants paid investment management fees or believed

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<sup>31</sup>Estimates in this statement have margins of error that are less than plus or minus 18 percentage points.

<sup>32</sup>The margin of error for this estimate is less than plus or minus 9 percentage points.

<sup>33</sup>The margin of error for this estimate is less than plus or minus 13 percentage points.

<sup>34</sup>Fee ranges for other services are not generalizable to the population of 401(k) plans. Of the plans sampled, we obtained other service fee information from 101 sponsors. We determined the response rate for this fee question was not large enough for us to provide reliable estimates that could be generalized to the population of 401(k) plans. Of sponsors who paid these fees, 75 percent of respondents said they paid less than 0.24 percent of plan assets annually.

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these fees were waived. While sponsors of plans of all sizes did not know about these fees, this was more prevalent among respondents who sponsor smaller plans than those sponsoring larger plans. For example, respondents of 57 percent of small plans (fewer than 50 participants) either did not know or claimed fees were waived, compared with 31 percent of large plans.<sup>35</sup> Most of the sponsors who said these fees were not paid or believed these fees were waived offered mutual funds, in which companies that manage these funds charge investment management fees regardless of whether a fund is in a 401(k) plan or sold to individual investors. Sponsors may not know if their plans paid investment management fees or believed fees are waived, because these fees are usually borne by participants and are typically charged against participants' assets, as opposed to invoiced to the plan sponsor.

Many plans have also not asked their providers about fees for investment-related services, such as 12b-1, sub-TA, or wrap fees, as shown in table 2. For example, sponsors of 82 percent of plans had not asked their service providers about sub-TA fees, which are typically used to reimburse a plan's record keeper for shareholder services, such as maintaining participant-level accounts and 70 percent had not asked about 12b-1 fees, which may be used to market and distribute the fund. According to our survey, over half of sponsors have not asked their service providers about any of the fees listed in table 2.

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<sup>35</sup>Estimates in this statement have margins of error that are less than plus or minus 15 percentage points.

**Table 2: Estimated Percentage of 401(k) Plan Sponsors Who Asked Their Providers about Certain Fees**

Survey question: Have you asked your provider for information on these fees?	Estimated percentage of total plans	
	Yes	No
a. <i>Marketing and distribution fees, also known as 12b-1 fees</i> , may be used to pay commissions to brokers and other salespersons, for expenses such as advertising and other costs of promoting the fund to investors.	30	70
b. <i>Sub-TA fees</i> , which are typically fees used to reimburse a plan's record keeper for shareholder services that the fund would have otherwise provided, such as maintaining participant-level accounts and distributing the fund's prospectus.	19	82
c. <i>Excess commission, also known as SEC rule 28(e) soft dollars</i> , which are extra commissions charged by brokerage firms and paid to investment advisers and others—in the form of services other than execution of securities transactions, such as research products—for directing business to brokerage firms.	15	85
d. <i>Trading/transaction costs</i> , which include commissions associated with an investment manager's buying and selling of securities within a particular investment vehicle, such as a mutual fund. These are the costs associated with portfolio turnover.	20	80
e. <i>Wrap fees</i> , which are generally associated with annuities, are aggregate fees that encompass multiple components, such as investment management fees, surrender charges, mortality and expense risk charges, and administrative fees.	21	79

Source: GAO analysis of Survey of 401(k) Plan Sponsors.

Note: Percentages may not total to 100 because of rounding.

Further, our survey also shows that the sponsors who had not asked about these fees were more likely to not know if these fees were paid. For example, as shown in figure 4, of the sponsors who reported that they had not asked their providers about 12b-1 fees, 64 percent did not know if their plans paid these fees.<sup>36</sup> Additionally, of the sponsors who had not requested information about wrap fees, which are typically associated with insurance accounts and annuities, about 50 percent of those sponsors did not know if these fees were paid.<sup>37</sup> Moreover, 17 percent of plans offered insurance company accounts, such as stable value funds, and 8 percent offered annuities, which typically charge a wrap fee, but over a quarter of those sponsors that offered insurance company accounts and annuities reported not paying wrap fees.

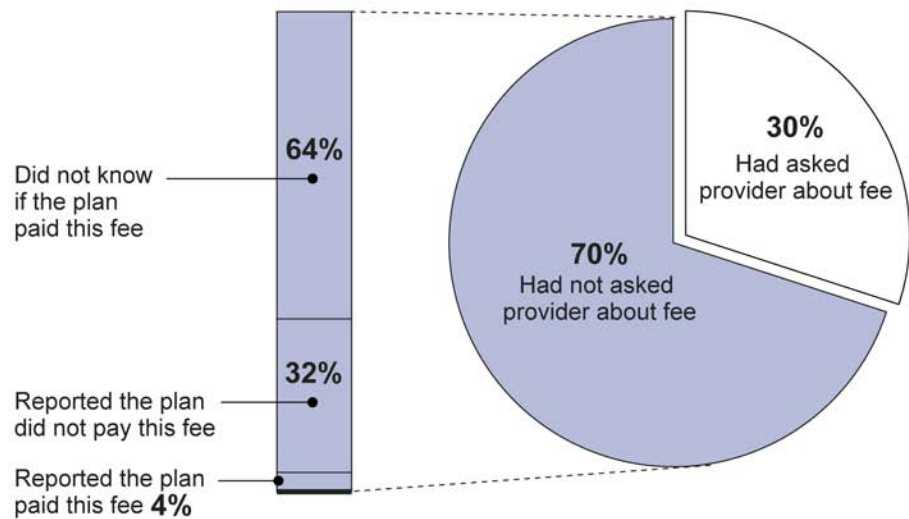
<sup>36</sup>The margin of error for this estimate is less than approximately plus or minus 9 percentage points.

<sup>37</sup>The margin of error for this estimate is less than approximately plus or minus 9 percentage points.

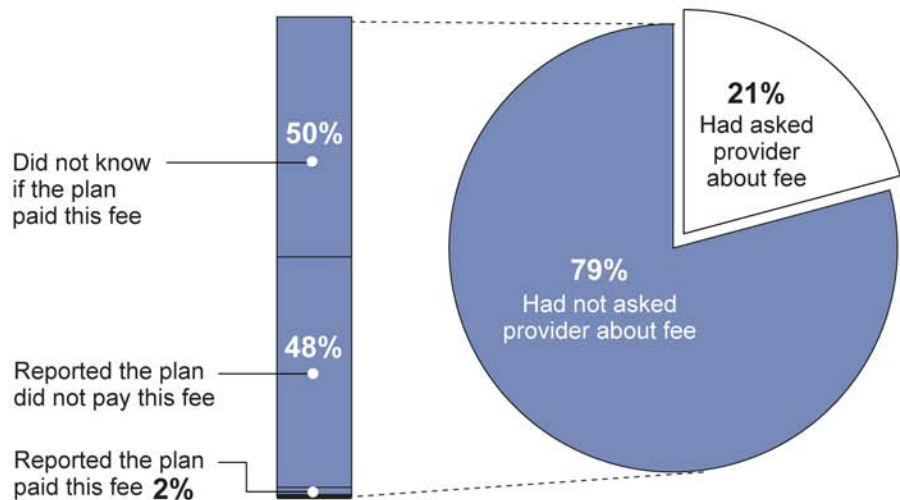


**Figure 4: Percentage of Respondents Who Reported Asking Their Providers about 12b-1 and Wrap Fees and Paid These Fees**

**12b-1 fees**



**Wrap fees**



Source: GAO analysis of Survey of 401(k) Plan Sponsors.

Note: Estimates in this figure have margins of error that are less than plus or minus 9 percentage points.

Last, of the sponsors that provided fee amounts, sponsors of about 24 percent of plans reported that they paid all investment management fees

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and participants paid nothing.<sup>38</sup> Among respondents who provided amounts, the range in fees these respondents paid was very minimal to 1.17 percent of plan assets.<sup>39</sup> However, as noted above, these fees are typically borne by participants and paid out of assets. While the amounts reported may reflect fees charged by service providers for investment-related services, it is unclear what these sponsors paid for.

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## Participants Ultimately Paid for 401(k) Plan Fees

### Recordkeeping and Administrative Fees Paid by Participants

Participants generally paid part or all of the fees charged for key 401(k) plan services. For example, even though in many plans the sponsor paid recordkeeping and administrative fees, our survey shows that participants also paid these fees. About 10 percent reported recordkeeping and administrative fees were paid for out of plan assets—from participants' accounts. For respondents who reported this information and provided amounts, participants paid between 0.02 percent and 1.59 percent annually, with an average of about 0.39 percent.<sup>40</sup> Respondents who sponsored smaller plans were more likely to pay these fees, and their participants tend to pay higher fees than participants in larger plans. Participants in small plans (fewer than 50 participants) paid an average of 0.43 percent annually.<sup>41</sup> Meanwhile, participants in larger plans—those with more than 500 participants—paid 0.22 percent.<sup>42</sup> We also found that in a few plans participants paid more than 1 percent in plan assets. Two of these plans used an insurance provider and offered insurance company accounts. Plans administered by insurance companies may have higher fees and expenses because wrap fees, which include components such as mortality and expense risk fees, are imposed on these products, according to Labor research.

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<sup>38</sup>The margin of error for this estimate is less than plus or minus 12 percentage points.

<sup>39</sup>Fee ranges for investment management services are not generalizable to the population of 401(k) plans. Of plans sampled, we obtained investment management fee information from 114 respondents. We determined the response rate for this fee question was not large enough for us to provide estimates that could be generalized to the population of 401(k) plans.

<sup>40</sup>The 95 percent confidence interval for this estimate is between 0.24 and 0.53.

<sup>41</sup>The 95 percent confidence interval for the estimated average of about 0.39 percent is between 0.24 and 0.62.

<sup>42</sup>The 95 percent confidence interval for this estimate is between 0.14 and 0.30.

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## Consulting and Advisory Fees Paid by Participants

Participants were more likely to pay for their plans' consulting or advisory services than plan sponsors. Plans may opt to hire a consultant or adviser to help the plan sponsor with various plan responsibilities, such as monitoring investments, selecting vendors, and negotiating fees or services with other providers. Our survey shows that 85 percent of plans hired a retirement plan consultant or investment adviser during 2010 to assist the sponsor with these services.<sup>43</sup> Overall, in 77 percent of plans, participants paid for the services rendered to the plan by these providers, while only 17 percent of plan sponsors paid these fees.<sup>44</sup> Among respondents who reported fee amounts, participants paid between 0.01 percent and 1.40 percent annually for these plan services.<sup>45</sup> In addition, on the basis of survey results, participants in smaller plans paid higher fees as a percentage of assets than participants in larger plans. For example, while the median amount participants in larger plans (500 or more participants) paid was 0.07 percent of assets, participants in smaller plans paid approximately 0.29 percent annually.

## Investment Management Fees Paid by Participants

Finally, as shown in figure 5, in about 73 percent of the plans, respondents said that participants paid 100 percent of investment fees, which are the largest share of 401(k) plan fees.<sup>46</sup> Among respondents who reported fee amounts, participants paid between less than 0.01 percent and 3.24 percent of assets.<sup>47</sup> The sponsor who said participants

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<sup>43</sup>We did not directly ask survey respondents if they hired a retirement plan consultant or investment adviser during calendar year 2010, but obtained information on plan sponsors' use of retirement plan consultants or investment advisers through two survey questions. First, we asked sponsors whether their plan's retirement consultant or investment adviser was a fiduciary, and 22 percent reported "fiduciary," 53 percent reported "not a fiduciary," 10 percent reported "do not know," and 16 percent reported "not applicable." For sponsors who responded "fiduciary," "not a fiduciary," or "do not know," we inferred that they used a retirement plan consultant or investment adviser. We determined this was a better gauge of use than a different question that asked sponsors whether their company or plan paid retirement plan consultant or investment adviser fees, because the response rate for this question was higher. See [GAO-12-550SP](#) for a copy of the full questionnaire.

<sup>44</sup>The margin of error for this estimate is less than plus or minus 17 percentage points.

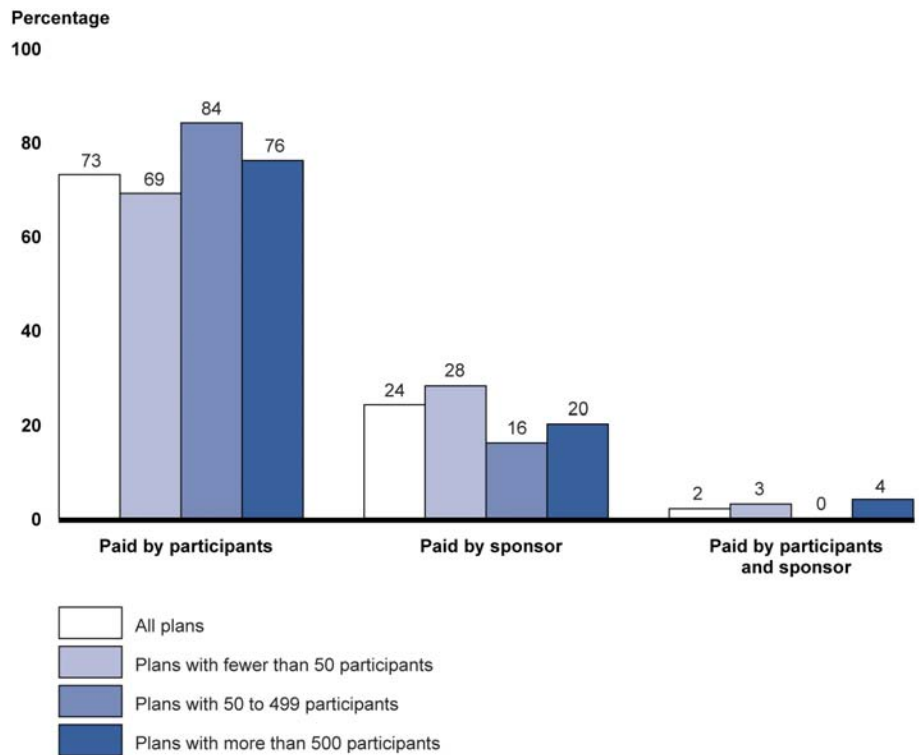
<sup>45</sup>Of the plans sampled, we obtained retirement plan consultant or investment adviser fee information from 64 sponsors. We determined the response rate for this fee question was not large enough for us to provide reliable population estimates. Of sponsors who paid fees, 50 percent reported participants paid between 0.03 percent and 0.12 percent of assets annually.

<sup>46</sup>The margin of error for this estimate is less than plus or minus 13 percentage points.

<sup>47</sup>As noted earlier, our estimates of investment management fees are not generalizable to the population of 401(k) plans.

paid approximately 3.24 percent in plan assets reported using an insurance company for investment options and did not know if different types of investment vehicles, such as mutual funds, were offered to participants. However, most respondents reported their plans paid less than 1 percent of plan assets. These tended to be older plans, in existence for at least 10 years, and those having more than \$1 million in plan assets. Among plans that paid more than 1 percent of assets, about half of these respondents told us that other factors such as the historical performance of a fund were more important than low investment fees when considering which options to offer within the plan.

**Figure 5: Among Respondents Who Provided Amounts, the Percentage of Investment Management Fees by Participants, Sponsors, or Both, 2010**



Source: GAO analysis of Survey of 401(k) Plan Sponsors.

Note: Percentages may not total to 100 because of rounding. Estimates in this figure have margins of error that are less than plus or minus 24 percentage points.

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## Plan Sponsors Were Challenged by Complex Fee Arrangements and Likely Paid More than They Realized

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### Some Sponsors Were Not Aware of Revenue Sharing Arrangements, Resulting in Higher Fees

Our review of select plans indicates that some plan sponsors did not understand the impact of third-party fee arrangements, also known as revenue sharing, on total plan fees.<sup>48</sup> Revenue sharing arrangements, in which fees for plan services are indirectly charged to the plan through an outside entity, can benefit plans if sponsors clearly understand how much they are paying for these types of arrangements and the services they can help provide. For example, according to a 2007 report by the ERISA Advisory Council's Working Group on Fiduciary Responsibilities and Revenue Sharing Practices, many of these arrangements may help reduce overall plan costs and provide plans with services and benefits that may not otherwise be affordable to them.<sup>49</sup> In addition, as we have previously reported, revenue sharing arrangements can be used to offset expenses the plan has agreed to pay, and can either be cost-neutral to the plan or may instead result in increased compensation to the service providers.<sup>50</sup> Our review found examples in which revenue sharing arrangements for

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<sup>48</sup>We reviewed 91 large and small plans based on the availability of sponsor-provided or third-party plan documents. Some sponsors did not provide additional documentation, and others provided documentation from which the presence of revenue sharing arrangements could not be accurately determined. Thus, the results of our review of these documents cannot be generalized to the population of all 401(k) plans. In addition, it was not the purpose, nor does GAO purport, to identify situations or circumstances in this report where plan sponsors or fiduciaries may have breached their fiduciary duties. Determining whether a fiduciary breach has occurred is based upon the facts and circumstances of each case. Our follow-up with plan sponsors was not aimed at reaching this determination. Therefore, our findings should not be read as indicating a breach of fiduciary or other obligation.

<sup>49</sup>The ERISA Advisory Council was created by ERISA to provide advice to the U.S. Secretary of Labor.

<sup>50</sup>GAO, *401(k) Plans: Improved Regulations Could Better Protect Participants from Conflicts of Interest*, [GAO-11-119](#) (Washington, D.C.: Jan. 28, 2011).

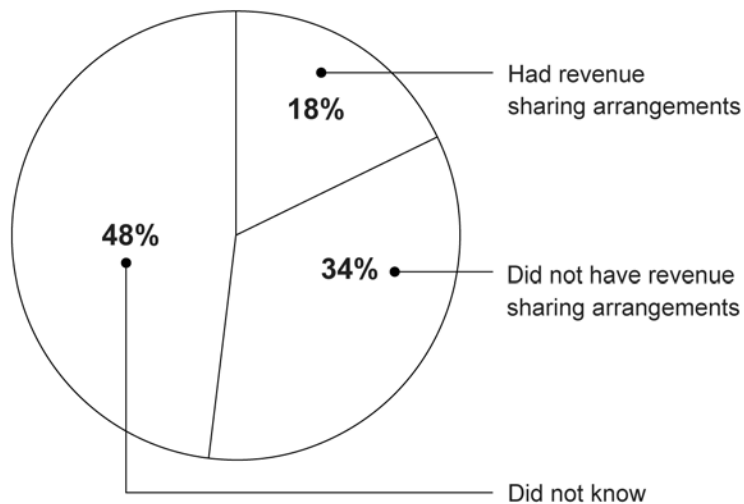
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recordkeeping and administrative services did not offset other fees, namely investment fees. In these cases, an additional asset-based fee for recordkeeping under a revenue sharing arrangement was charged on top of each fund's reported expense ratio, as opposed to a lower rate.

Service providers and consultants we spoke with noted that plan sponsors typically do not fully understand revenue sharing arrangements. One industry expert explained that plan sponsors are commonly not aware of fees or fee arrangements disclosed outside of the expense ratio. Representatives from a consulting firm told us that some of their clients possess a good understanding of revenue sharing, but most have no understanding of revenue sharing and the potential impact on plan fees. As shown in figure 6, sponsors of an estimated 48 percent of plans did not know if their service providers had revenue sharing arrangements with other providers. Furthermore, 51 respondents that reported being aware of revenue sharing also reported that they did not consider the revenue sharing arrangements when selecting service providers, or that they did not have enough information to do so.

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**Figure 6: Estimated Percentage of 401(k) Plans with Revenue Sharing Arrangements as Reported by Plan Sponsors**



Source: GAO analysis of Survey of 401(k) Plan Sponsors.

Plan sponsors who reported not having or not knowing if their providers had revenue sharing arrangements may, in fact, have had these arrangements and were not aware of it. Our review found that at least 45 of the 91 plan sponsors who provided investment reports had revenue sharing arrangements, despite reporting not having or not knowing of

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such arrangements.<sup>51</sup> Some of the documents provided by these plan sponsors specifically identified revenue collected from or paid to third parties for plan services, such as recordkeeping and investment adviser fees. Evidence of revenue sharing was also found through our review of some of the funds these plans invested in, which showed that 12b-1 fees were charged.<sup>52</sup> Similarly, plans paid sub-TA fees, but about 50 percent of sponsors reported not knowing if these fees were paid during calendar year 2010. For example, one provider discloses that it receives revenue sharing fees, including sub-TA fees, but 7 of the 24 survey respondents that contracted with this provider reported that they did not know if their plans paid these fees. According to examples we found, in which the plan sponsor may not have been aware of revenue sharing arrangements, fees paid under such arrangements varied.

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<sup>51</sup>Of the 262 respondents who said they did not have, or did not know if their plan had, revenue sharing arrangements, 91 provided additional investment documentation. Of these 91 respondents who provided additional documentation, we were able to determine that 45 plans had some sort of revenue sharing arrangement. We determined this both by noting provided documents that explicitly identified such arrangements and by reviewing fund prospectuses of investment options and finding at least one option that charged 12b-1 fees. Of the remaining 46 respondents, some had provided documents with inadequate or insufficient information with which to determine specific fund names or share class information.

<sup>52</sup>SEC Rule 12b-1 allows mutual funds to pay for marketing and distribution expenses directly from fund assets. Known as 12b-1 fees, these can range from 0.25 to 1 percent of plan assets. Not all funds pay 12b-1 fees and, within a fund, some share classes may pay 12b-1 fees while other share classes do not. While 12b-1 fees are included in a fund's expense ratio, SEC has noted that many investors do not understand these fees nor are they aware the fees are being deducted from their investments. See SEC 17 C.F.R. Parts 210, 239, 240, 249, 270 and 274. SEC has proposed new rules to replace Rule 12b-1 with a new framework that would separately regulate service fees and asset-based sales charges. See Mutual Fund Distribution Fees; Confirmations, 75 Fed. Reg. 47,064 (Aug. 4, 2010)(to be codified at 17 C.F.R. pts. 210, 239, 240, 249, 270 and 274). As of March 2012, SEC's proposal has not yet been finalized.

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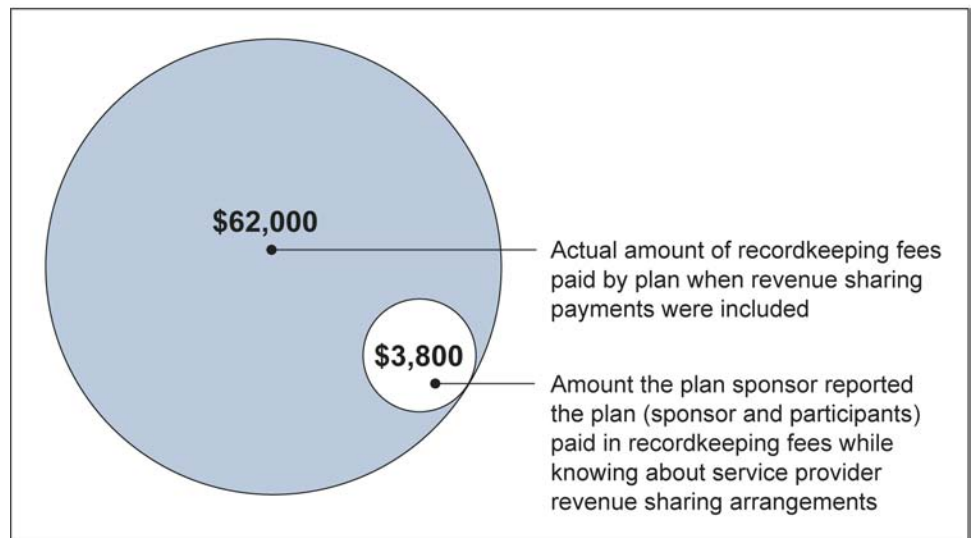
**Examples in Which Sponsors Unknowingly Paid Certain Fees under a Revenue Sharing Arrangement**

- The sponsor of a plan that had about \$6 million in assets reported not knowing if its plan paid 12b-1 fees, even though a review of its investment documents indicated that the plan paid about \$5,000 in 12b-1 and other revenue sharing fees.
- The sponsor of a medium-size plan with over \$4 million in plan assets reported that participants did not pay for recordkeeping and administrative services—when in fact the provider estimated that about 43 percent of the fees collected by fund providers from participants' accounts, roughly \$13,000, would be used to pay for recordkeeping and administrative services.

Moreover, even plan sponsors that were aware of revenue sharing arrangements may not fully understand the impact of these arrangements on plan services and plan fees, and therefore likely paid higher fees than they reported. For example, our review of the fee report of a 401(k) plan that used revenue sharing and had over 500 participants and approximately \$13.5 million in plan assets found that the plan sponsor and participant paid 16 times more in recordkeeping and administrative fees during calendar year 2010 than the sponsor reported on our survey, when we included revenue sharing fees, as shown in figure 7. Similarly, the plan sponsor of a small plan that had about 65 participants and about \$5.8 million in plan assets reported that the company did not pay anything for recordkeeping and administrative fees, though the fee report the sponsor provided indicated that these fees in total were about \$10,700—about \$5,900 was invoiced to the company and roughly \$4,800 was paid to the provider from revenue sharing fees collected from participants' asset accounts.



**Figure 7: Difference between Actual Recordkeeping Fees Paid by One Plan in 2010 and Those Reported by the Plan Sponsor under a Revenue Sharing Arrangement**



Source: GAO analysis of Survey of 401(k) Plan Sponsors.

Note: In this example, while the plan sponsor reported that it paid \$1,400 and participants paid approximately \$2,400 out of plan assets for recordkeeping and administrative services, a review of the plan's calendar year 2010 investment revenue report shows that more than \$62,000 was paid for these services. In addition, the sponsor reported that the companies that service the plan had revenue sharing arrangements with other service providers, which was disclosed in a written contract and discussed between the sponsor and provider.

A failure to understand these arrangements can have adverse effects on the plan sponsor and participants. For example, because recordkeeping fees under a revenue sharing arrangement can be based on the amount of plan assets under management, the amount paid to the provider for recordkeeping services could increase as the fund grows and may get quite large if the sponsor is unaware of these asset-based fees. This could result in the plan—the sponsor and participants—continuing to pay more for recordkeeping services as assets grow, although the level of recordkeeping services provided tends to remain the same. A short video illustrating a hypothetical example of how revenue sharing arrangements can work and how the fees for services change over time under such an arrangement is available at

[http://www.gao.gov/multimedia/video/#video\\_id=590296](http://www.gao.gov/multimedia/video/#video_id=590296) .

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## Insurance Product Fees Can Be Difficult for Plan Sponsors to Identify and Evaluate

Fees associated with certain 401(k) insurance products—where participants pay for some benefits but which otherwise appear similar to noninsurance 401(k) products—can be difficult for sponsors to identify and therefore evaluate. Some service providers we met with said that plan sponsors do not often know they are invested in insurance products such as group variable annuities, which are products that place a “wrapper” of benefits, namely a guaranteed lifetime annuity income or a minimum death benefit, around a bundle of investments that are similar to mutual funds—called separate accounts or subaccounts—and are unaware of the associated fees. They suggested that it is difficult for sponsors to distinguish between group variable annuity contracts and mutual funds, because the insurance company’s separate or subaccounts often use the same name as the mutual funds, as depicted in figure 8. However, representatives from one insurance provider said its separate accounts are invested in the mutual fund for which it is named, but acknowledged that other providers may mimic the fund rather than investing in the fund.

Figure 8: A Hypothetical Example of Two Different 401(k) Investment Options with Similar Names

401(k) Without  
an Annuity Contract

		Estimated Operating Expenses			
		Date as of: 12/31/2010			
Investment Vehicle	Ticker	Plan Assets	Prospectus Net Expense Ratio %	Expense Ratio Date	Estimated Annual Expenses
<b>U.S. Stocks</b>					
Mid Cap B	MMMMM	\$8,836.43	1.21	9/30/2010	\$106.92
Small Companies A	SSSSS	\$638.50	1.49	10/31/2010	\$9.51
<b>Bonds</b>					
High Income A	HHHHH	\$32,038.85	0.95	10/31/2010	\$304.37
Mutual Fund A	AAAAA	\$1,816.13	0.90	12/16/2010	\$16.35
<b>Global/International</b>					
International Index A	IIIII	\$5,350.78	0.60	12/03/2010	\$32.10

401(k) With a  
Group Annuity  
Contract Offered  
Through an  
Insurance Company

STATEMENT OF ASSETS AND LIABILITIES OF THE SUB-ACCOUNTS OF JONES CORP LIFE INSURANCE COMPANY (U.S.A) Money invested as of December 31, 2010			
Sub-Accounts	Total Sub-Accounts Assets and Liabilities	Total Number of Units	Total Value
Global Bond Fund	\$70,160,610.20	0.00	0.00
Income Fund	\$196,849,929.95	11.739102	241.34
Mutual Fund A	\$ 243,687,944.95	20.004585	347.89
Balanced Fund	0.00	0.00	0.00

Source: GAO analysis of information from industry practitioners.

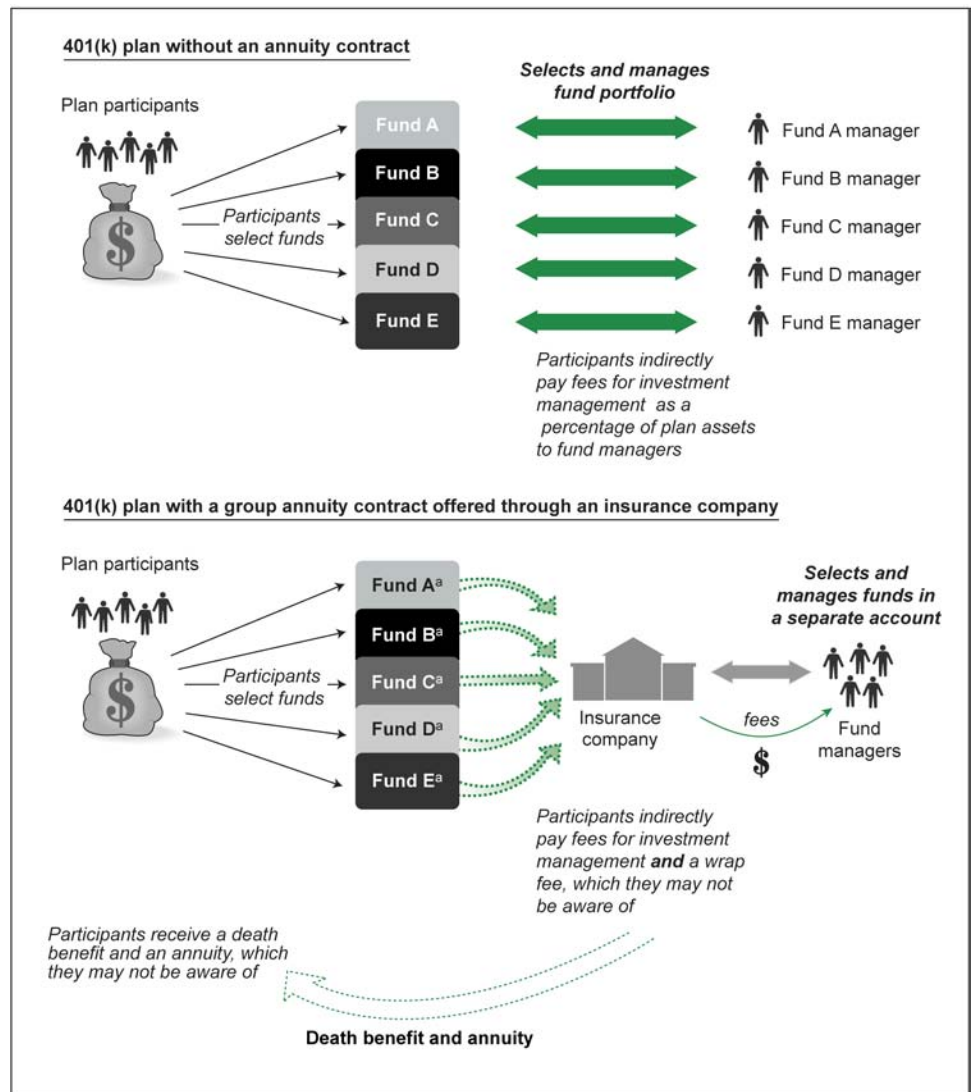
Note: In the example above, although the two investments from each plan look the same and appear to both be the mutual fund, Mutual Fund A, in fact there are important differences between the two. For example, the top statement is a plan without an annuity contract; thus the investment, Mutual Fund A, is the publicly traded mutual fund, as signified with a ticker symbol. In contrast, the investment from the bottom statement is in a plan with a group annuity contract; thus the investment is a subaccount of the insurance provider, which is potentially designed to mimic Mutual Fund A's investment strategy. As a result of their similarities, a plan sponsor may believe these are the same investment option. However, because these are different investments, they may have different fees, which may not be known to the plan sponsor.

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In addition, our survey shows that about 17 percent of sponsors did not know if their plans had group variable annuity contracts. Furthermore, although sponsors of 72 percent of plans reported not having a group variable annuity contract, our analysis of their submitted investment statements indicates that some do currently have these contracts and are unaware of them. According to our review, it appears that at least 15 of the plans that provided investment documents and reported not being in a group variable annuity contract may actually be under such a contract.

The various ways that information about these contracts is disclosed can make it difficult to determine with certainty whether or not sponsors have these contracts. As shown in figure 9, a 401(k) group annuity contract and a 401(k) plan without such a contract may look very similar. For example, the sponsor of a small plan with about 12 plan participants did not know if the plan had a group variable annuity contract. However, the statement provided by the sponsor noted that the plan was a group variable contract, and included a mortality, expense, and administrative charge—charges by an insurance company to cover the cost of insurance features in an annuity contract. Similarly, another plan sponsor we met with told us its plan did not use group annuity contracts; its advisers, however, later clarified that the sponsor's plan is, in fact, a group variable annuity contract and charges wrap fees at 0.1 percent of plan assets. The advisers explained that these contracts are not often identified as group variable annuity contracts and suggested that a lot of sponsors would not know if their plans had such contracts. Another sponsor told us that its third-party administrator told it that its plan was not under a group annuity contract, even though it was stated on the plan's investment report, because the provider, which is an insurance company, was required to disclose its group annuity contract terms on all plan documents, regardless of the actual terms.

**Figure 9: A Hypothetical Comparison of 401(k) Plans with and without Group Annuity Contracts**



Source: GAO analysis of information from industry practitioners.

<sup>a</sup>The insurance company contracts with fund managers and pays fees to create separate accounts that look like the publicly available named funds, but which are available only as investments to participants in plans that contract with that insurance company.

Fees associated with group annuities can add significant costs to a plan. The additional fees for group annuity contracts—known as wrap fees—include administrative fees and a mortality and expense risk charge, which is typically in the range of 1.25 percent of assets per year. We also

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found that in addition to each fund's expense ratio, an insurance provider's administrative service fees were up to 2.00 percent of plan assets for a few plans that responded to our survey. Furthermore, two service providers we met with said that they will often discourage their clients from using group annuities, and one noted that it was able to reduce one plan sponsor's fees by about \$90,000 off a total of \$300,000 by switching the plan away from group annuities to mutual funds. However, another provider told us that it packages a range of services into its group annuity contracts and spread fees out over a number of years, making it more affordable for smaller plans to offer their employees a retirement plan. In addition to ongoing fees, these contracts also typically charge a surrender fee for terminating the contract, which may begin in excess of 4 or 5 percent, according to one service provider, but typically decline over a period of about 5 or 7 years after a purchase payment. As these fees can be significant, plan sponsors are likely contracting with providers that charge higher fee rates without knowing the benefits for which they and their participants are paying. Moreover, without being aware of whether or not their plan is a group annuity contract, for example, plan sponsors cannot adequately assess whether or not the benefits tied to that product are worth the fees associated with them.<sup>53</sup>

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<sup>53</sup>The potential benefits for plan participants arising from a group annuity contract can include the option of converting the account balance into a guaranteed lifetime income (though participants could also purchase annuity contracts outside the plan). An assessment of the benefits to plan participants of group annuity contracts, in comparison with the fees, is beyond the scope of this report.

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#### **Examples of the Fee Amounts Paid by Small and Large Plans with Group Annuity Contracts**

- A small plan with approximately \$1.2 million in plan assets paid approximately \$20,600 in fees and about 37 percent of that (\$7,700) were mortality, expense, and administrative fees.
- Another plan, with approximately \$2.7 million in plan assets, reported paying wrap fees of 0.1 percent of plan assets, or about \$2,700 for the plan year, after the plan's providers negotiated for lower fees.
- A large plan with about \$19.3 million in group annuity assets paid 0.14 percent of plan assets, or approximately \$27,000, in administrative maintenance charges

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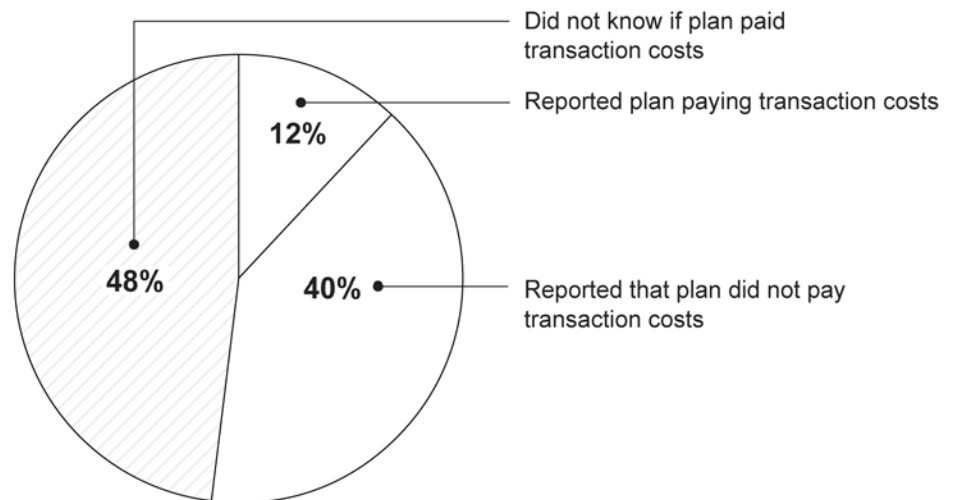
#### **A Majority of Sponsors Did Not Know about Commonly Charged Transaction Costs**

Many plan sponsors may not be aware that their participants are paying potentially significant transaction costs (also known as trading costs), which are commonly paid for indirectly by plan participants out of fund assets and typically include commissions associated with an investment manager's buying and selling of securities within a particular investment vehicle.<sup>54</sup> While transaction costs are common among mutual funds, and more than 80 percent of 401(k) plans in our survey offer mutual funds, sponsors of an estimated 48 percent of plans did not know if their plans—through the deduction from participants' returns of investments—incurred transaction costs. In fact, as shown in figure 10, only an estimated 12 percent of sponsors said that their plans incurred these costs.

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<sup>54</sup>There are also "transaction costs" associated with plan participant actions, such as withdrawals and taking a loan from their 401(k) plan accounts; however, this meaning of transaction costs differs from the types of transactions referred to in this report.

**Figure 10: Percentage of Sponsors Who Reported That Transaction Costs Were Charged in 2010**



Source: GAO analysis of Survey of 401(k) Plan Sponsors.

Of the sponsors that did not know if their plan participants were charged transaction costs, about 95 percent of them also reported that they had not asked their service providers for information regarding transaction or trading costs. Even those that did ask about these fees sometimes did not know whether their plan participants were charged transaction costs. For example, a plan sponsor of a large plan with 15,000 participants and over \$100 million in plan assets told us that its plan does not pay transaction or trading costs, and that it has asked its service provider for information on these fees. However, on the basis of BrightScope's estimates, the plan was charged about \$310,400 in transaction costs.<sup>55</sup>

<sup>55</sup>BrightScope estimates transaction cost by taking into account a fund's disclosed brokerage commissions and estimates spread costs, market impact costs, and opportunity costs using the fund's turnover rate, total net assets, and the asset allocation of the portfolio of underlying assets.



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### **Calculating Transaction Costs**

SEC has identified four major types of mutual fund transaction costs: commissions, spread costs, market impact costs, and opportunity costs. However, no industrywide standard currently exists for calculating transaction costs. Different researchers and private sector companies have developed various methods to determine transaction costs. For example, one researcher focuses on spread costs, brokerage commissions, and tax costs using individual fund quarterly reports of stocks traded and SEC filings, while another researcher estimates trading costs using price impacts and effective bid-ask spreads. Adding to the difficulty of estimating transaction costs is the fact that even though mutual funds have transaction costs associated with them, they are not uniformly measured or disclosed

Transaction costs vary by different types of investment vehicles. Our review of BrightScope data for 83 plan sponsors that responded to our survey and had corresponding BrightScope data suggests that transaction costs for an investment option can be as high as 2.72 percent.<sup>56</sup> However, average transaction costs for the investment options offered in the plans we reviewed were approximately 0.45 percent of assets. Even though transaction costs for individual funds are high, the amount a participant or plan pays may be lower depending on how much is invested in these high-cost options; for example, for the plan that had an investment option with a transaction cost of 2.72 percent, only 6.57 percent of plan assets were invested in that option, resulting in transaction costs of 0.18 percent of total plan assets. Different types of investment options yield different amounts of transaction costs. For example, more actively managed funds may have higher transaction costs than less actively managed funds because they often have a higher turnover. More actively managed investment options with higher turnovers could benefit participants by producing a higher return; however, their higher transaction costs may or may not lead to a higher net return.

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<sup>56</sup>Our analysis of transaction costs was limited to the 83 plans in our sample that BrightScope also estimated transaction costs for, when we downloaded BrightScope reports in September 2011. BrightScope generally did not have transaction costs for plans with fewer than 100 participants; see appendix II for additional details about BrightScope fee data.

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## Labor Has Taken Actions to Help Sponsors, but Additional Efforts Are Needed to Effectively Oversee Fees Charged by Service Providers

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### Labor Has Educational Resources, but Sponsors Reported Not Using Them

Labor has made information, guidance, and tools regarding plan fees available to plan sponsors on its website, but our survey shows that many sponsors are not using these resources. For example, Labor undertook several educational initiatives to help sponsors ensure that the services provided to their plans are necessary and the fees for those services are consistent with ERISA requirements. We also recently reported that Labor developed online tools and a website to specifically help small plan sponsors navigate retirement plan information and make informed decisions about plan options.<sup>57</sup> In addition, Labor has created a fiduciary education program intended to provide all plan sponsors and other plan officials with an understanding of the law and their responsibilities, with an emphasis on obligations, such as understanding the terms of their plans and selecting and monitoring service providers. The program includes holding nationwide educational seminars and webcasts on topics such as fees. As part of this initiative, Labor also distributes a number of publications and tools for sponsors, including a model fee disclosure form, to help them review and compare the fees charged by service providers. As described in table 3, Labor distributes other key publications, which are available to sponsors on its website. [www.dol.gov](http://www.dol.gov).

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<sup>57</sup>GAO-12-326.

**Table 3: Description of Key Publications Related to 401(k) Plan Fees on the Department of Labor’s Website**

Publication	Description
<i>401(k) Plan Fee Disclosure Form</i> (1999) <sup>a</sup>	This 401(k) plan fee disclosure form is aimed to assist plan sponsors in making informed cost-benefit decisions with respect to their plans. The purpose of the form is to help sponsors determine the total cost of the plan. It is also intended to provide sponsors with a means to compare investment product fees and plan administration expenses charged by competing service providers, regardless of how a particular service provider structures its fees.
<i>A Look At 401(k) Plan Fees</i> (1999)	<p>A booklet that answers some common questions about 401(k) plan fees and expenses that may be paid by 401(k) plans. It highlights the most common fees and encourages 401(k) plan participant to</p> <ul style="list-style-type: none"> <li>• make informed investment decisions,</li> <li>• consider fees as one of several factors in decision making,</li> <li>• compare all services received with the total cost, and realize that cheaper is not necessarily better.</li> </ul> <p>The booklet also includes a 401(k) Fees Checklist, which is 10 questions to help gather information about fees and expenses paid by a plan.</p>
<i>Meeting Your Fiduciary Responsibilities</i> (2010)	A booklet that addresses the scope of ERISA’s protections for private sector retirement plans. It provides a simplified explanation of the law and regulations, including a description of who a fiduciary is and fiduciaries’ responsibilities. These responsibilities may include hiring a service provider and understanding the fees charged and the services provided.
<i>Study of 401(k) Plan Fees and Expenses</i> (1998)	The study includes a description of the various mechanisms used to provide administrative and investment management services for 401(k) plans. It describes different fee structures faced by plan sponsors when they purchase services from outside providers and the ranges of expenses resulting from those fee structures.
<i>Understanding Retirement Plan Fees and Expenses</i> (2004)	A booklet to mainly help 401(k) plan sponsors better understand and evaluate plan fees and expenses. The booklet describes various plan fees, including administration, investment, and individual service fees, and who typically pays these fees. It also provides guidance on the steps sponsors can take to evaluate plan fees.

Source: Labor.

Notes: In addition to these publications, Labor also published two tip sheets aimed at assisting small business owners with service provider selection: (1) *Tips For Selecting And Monitoring Service Providers For Your Employee Benefit Plan*, and (2) *Selecting And Monitoring Pension Consultants - Tips For Plan Fiduciaries*.

<sup>a</sup>This document was developed by the American Bankers Association, the American Council of Life Insurance, and the Investment Company Institute, and distributed by Labor.

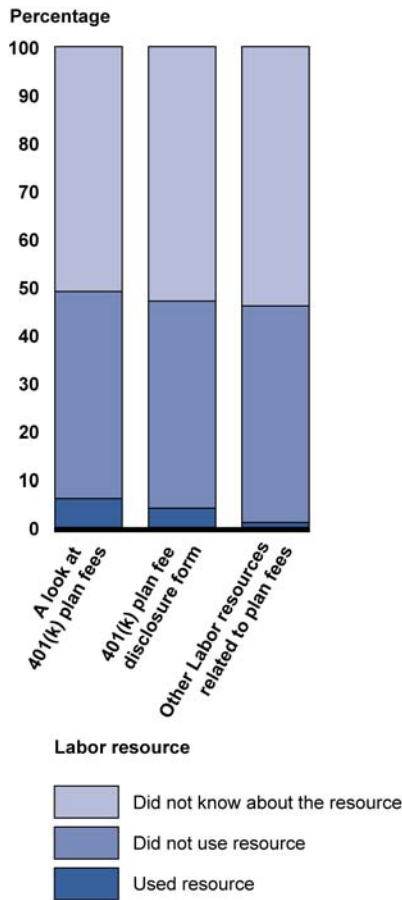
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However, as shown in figure 11, our generalizable survey results indicate that the majority of plan sponsors either did not use Labor’s resources to compare and assess fees or did not know about them. Specifically, on the basis of our survey of plan sponsors, we estimate that sponsors of less than 6 percent of 401(k) plans used Labor’s publication *A Look At 401(k) Plan Fees*, which includes a 401(k) fees checklist, when comparing and assessing the fees charged by their various providers. In addition to the resources we specifically asked about, one sponsor noted using Labor’s Frequently Asked Questions, available on its website, but also reported not knowing how much the plan paid in investment management and consulting fees. Another sponsor, who did not know about Labor’s resources, commented that Labor’s website is massive, which could make it difficult to access 401(k) information. Additionally, in March 2012, we reported that many small employers with retirement plans were unaware of Labor’s education and outreach initiatives and recommended that Labor take steps to enhance the visibility and usefulness of federal guidance on retirement plans for small employers.<sup>58</sup>

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<sup>58</sup>[GAO-12-326](#).

**Figure 11: Estimated 401(k) Plan Sponsors' Use of Labor's Educational Resources to Compare and Assess Fees**



Source: GAO analysis of Survey of 401(k) Plan Sponsors.

Sponsors typically rely on their service providers for plan fee information and advice, which may be one reason sponsors do not use the resources on Labor's website. Our prior work indicated that small employers use plan service providers to address various aspects of plan administration and may lack the financial resources and in-house expertise to manage a plan. Our survey of small and large plan sponsors shows that about 95 percent of plans hired outside entities, such as a plan consultant, an investment adviser, or a third-party administrator, to help with plan functions. In survey comments, some sponsors told us that their service providers either provided or could provide other types of information, such as a breakdown of fees by services performed or comparative plan size benchmarking data, to help ensure the services provided to the plan are

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necessary and the fees for those services are reasonable. However, our survey results do not indicate that Labor's efforts are reaching its target audience, even though it aims to educate and assist employers, particularly small employers, in understanding their obligations under the law and related regulations.

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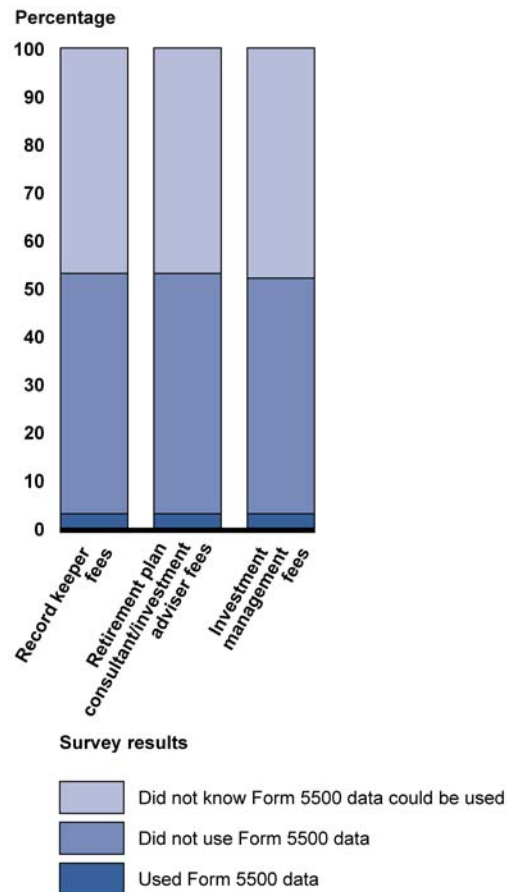
**Labor Has Improved Form 5500 Data, but Sponsors Do Not Use the Information**

Labor has also made changes to the Form 5500, expanding plan data available to sponsors and others, but sponsors are not using the additional information to help them manage their plans. In particular, an updated Form 5500 Schedule C requires plan sponsors to collect and classify the fees they pay service providers as either direct or indirect compensation. Although these changes were implemented for plan year 2009 filings, understanding indirect fees continues to challenge plan sponsors, as we noted in the previous section of this report. On the basis of our survey, of those that reported completing Form 5500 Schedule C, the additional compensation information helped sponsors of an estimated 17 percent of plans negotiate fees with their current providers.<sup>59</sup> Furthermore, even less, between 2 and 3 percent, reported that Form 5500 information was used to compare fees paid with those charged by other providers. As shown in figure 12, sponsors did not know or use Form 5500 information to compare or assess fees charged by various service providers. Specifically, sponsors of an estimated 50 percent of plans did not use Form 5500 data available on Labor's website to compare and assess record keeper fees, and about 47 percent did not know the data could be used for this purpose. Moreover, industry experts and sponsors told us that plan reporting is an onerous and costly part of operating and maintaining a 401(k) plan.

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<sup>59</sup>The margin of error for this estimate is plus or minus 14 percentage points.

**Figure 12: Estimated 401(k) Plan Sponsors' Use of Form 5500 Data to Compare and Assess Fees for Select Services**



Source: GAO analysis of Survey of 401(k) Plan Sponsors.

In addition, even if sponsors wanted to use Form 5500 data from other plans to determine fees, they would be hindered because of several limitations we found, such as the inability to search for reports of plans with similar features or the same provider to compare fees. Table 4 describes some limitations that pose obstacles to sponsors using Form 5500 data.

**Table 4: Key Obstacles to Using Form 5500 Data to Assess 401(k) Plan Fees**

Limitation	Explanation of limitation
Explicit fees not reported	<p>We previously reported that not all plan fees are explicitly reported on the Form 5500.<sup>a</sup> For example, the investment management fees associated with mutual funds are not explicitly reported on the Form 5500, a fact that, in turn, has limited Labor's ability to identify fees that may be questionable. Although it is important for the additional fee information to be reported to Labor, some useful plan and fee information, such as explicit fees reported in the income and expense statement, could help sponsors monitor and compare fees.</p>
Limited web-based search function	<p>Access to fee information collected under Labor's new web-based Form 5500 filing system for the purpose of benchmarking or comparing fees remains limited.</p> <ul style="list-style-type: none"> <li>• Currently, users can search for and download individual returns filed through the ERISA Filing Acceptance System 2 (EFAST2), but the search functions are limited to filtering the data by a few variables, such as the plan name, Employer Identification Number, and system-generated variables, which has little to no meaning to the general public.</li> <li>• At the same time, this system does not easily allow a user, such as a plan sponsor, to review aggregated data from multiple plans to identify amounts and trends in fees charged by service providers for plans that may be similar in size or nature of business.</li> </ul>
Data not presented in a usable or understandable format	<p>Sponsors and others can download all filings by plan year from Labor's website to create their own customized reports from the unedited publicly available Form 5500 data. However, these files are large, with hundreds of thousands of records, and would be difficult to analyze without additional support from Labor or an experienced data analyst.</p> <p>Additionally, the Form 5500 dataset files, which contain filings for all plans within a plan year, are not presented in an understandable or usable format.</p> <ul style="list-style-type: none"> <li>• While users can download the data, there is no user's guide similar to the one distributed for Labor's research file with key information, such as a description of the variables, the corresponding item number on the Form 5500, and data limitations, needed to help users understand and mine the data for key information about plan trends and fees.</li> <li>• Additional information from Labor is needed for users to determine which record/filing is the most current and accurate. During the course of our data reliability assessment of the datasets, we found that some files for each plan year contained more than one record for a single unique plan as some plans submit amended filings.</li> <li>• Sponsors would also need to take steps to edit the data before they could use them. For instance, we took several steps to accurately identify the population of 401(k) plans, such as reviewing plan names for the term "401(k)," because, according to Labor officials, sponsors did not always update or correctly identify the plan as a 401(k) plan under plan characteristics.<sup>b</sup> Labor researchers, who produce Labor's Form 5500 research files, and others also adapt the data to improve the accuracy of the data.</li> </ul>

Source: GAO analysis.

<sup>a</sup>GAO, *Private Pensions: Additional Changes Could Improve Employee Benefit Plan Financial Reporting*, [GAO-10-54](#) (Washington, D.C.: Nov. 5, 2009).

<sup>b</sup>For additional information on the steps we took to review and edit Form 5500 data, see appendix II.

As of December 2011, Labor did not have plans to address these limitations. For example, while Labor is developing an online search capability for pre-2009 filings, which are currently not searchable, it does not have plans to expand the search functions and capabilities for information filed under the new Form 5500 web-based filing system.



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Labor has also not taken steps to make additional information about the publicly available pre-2009 Form 5550 data to help sponsors and others use it more effectively.

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### Service Provider Disclosure Regulations May Help Plan Sponsors Better Understand Fees

We previously reported that service provider disclosures can be very complicated and difficult to understand, which could reduce their usefulness to plan sponsors.<sup>60</sup> Our survey results also indicate that even when certain service provider business arrangements, such as revenue sharing, are disclosed to sponsors, they may not fully understand how these arrangements affect plan fees.<sup>61</sup> On February 3, 2012, Labor finalized the regulations regarding disclosure of service providers' direct and indirect compensation, which is intended to provide sponsors with information to assess the reasonableness of fees received by plan service providers, their affiliates, and subcontractors.<sup>62</sup> Additionally, the final rule encourages service providers to provide the information in a summary format or offer a guide to sponsors to help them locate information, but does not require such actions.<sup>63</sup> However, our survey also shows that sponsors contract with more than one provider, some of which have revenue sharing arrangements with other providers. Therefore, under the final rule, sponsors could receive disclosure statements in different formats from different providers, which may further contribute to sponsors' confusion about plan fees. We previously recommended that Labor require that the service provider disclosures be provided in a consistent and summary format, and in light of our survey

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<sup>60</sup>[GAO-11-119](#).

<sup>61</sup>We administered our survey of 401(k) plan sponsors on fees before Labor finalized the regulations regarding disclosure of service providers' direct and indirect compensation.

<sup>62</sup>Reasonable Contract or Arrangement Under Section 408(b)(2)—Fee Disclosure, 77 Fed. Reg. 5632 (Feb. 3, 2012)(to be codified at 29 C.F.R. pt. 2550).

<sup>63</sup>In the Fall 2011 Regulatory Agenda, Labor announced plans to publish a proposed amendment to its final regulation under ERISA section 408(b)(2) to request public comment on a requirement that service providers furnish a guide or similar tool to assist plan fiduciaries, especially fiduciaries to small and medium-sized plans, in identifying required fee disclosures in potentially lengthy, complex, or multiple documents. The preamble to Labor's final regulation also notes that Labor intended to publish a Notice of Proposed Rulemaking to request public comments on whether covered service providers should be required to furnish a guide or similar tool with the required fee disclosures. 77 Fed. Reg. 5632 (Feb. 3, 2012)(to be codified at 29 C.F.R. pt. 2550).

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results, making these actions a requirement and not voluntary on the part of service providers may be useful to plan sponsors.<sup>64</sup>

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### Labor Is Reexamining the Definition of a Fiduciary, but Additional Efforts Could Help Sponsors and Others

Labor has also taken steps to broaden its oversight of service providers, particularly investment advisers, which may help sponsors in their role as plan fiduciaries, but the impact of its actions remains to be seen. In October 2010, Labor proposed regulations to amend the definition of an ERISA fiduciary to account for significant changes in both the financial industry and the expectations of plan officials and participants who receive investment advice by reducing the number of conditions that need to be met to be deemed an ERISA fiduciary. These changes would likely allow Labor to oversee a broader range of plan providers. However, on September 19, 2011, Labor withdrew its proposal, citing the need for more public input and announced that it will repropose its rule in 2012.<sup>65</sup>

While Labor's initial proposal to amend the definition of an ERISA fiduciary may help reduce confusion on the part of plan sponsors with respect to their providers that provide investment advice, it may not address any unclear roles related to a variety of other providers that have considerable influence over the plan sponsor. Our survey results show that, on the basis of respondents' perceptions, various providers other than investment advisers also serve as plan fiduciaries, but some may not be considered fiduciaries under current and proposed regulations.<sup>66</sup> For example, of those that use a third-party administrator, sponsors of an estimated 14 percent of plans reported that their administrator also served as a plan fiduciary. Sponsors also reported that some bundled service providers served as fiduciaries. However, most service providers,

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<sup>64</sup>[GAO-11-119](#).

<sup>65</sup>EBSA News Release No. 11-1382-NAT, Sept. 19, 2011. As of March 2012, no revisions to the proposal had been announced.

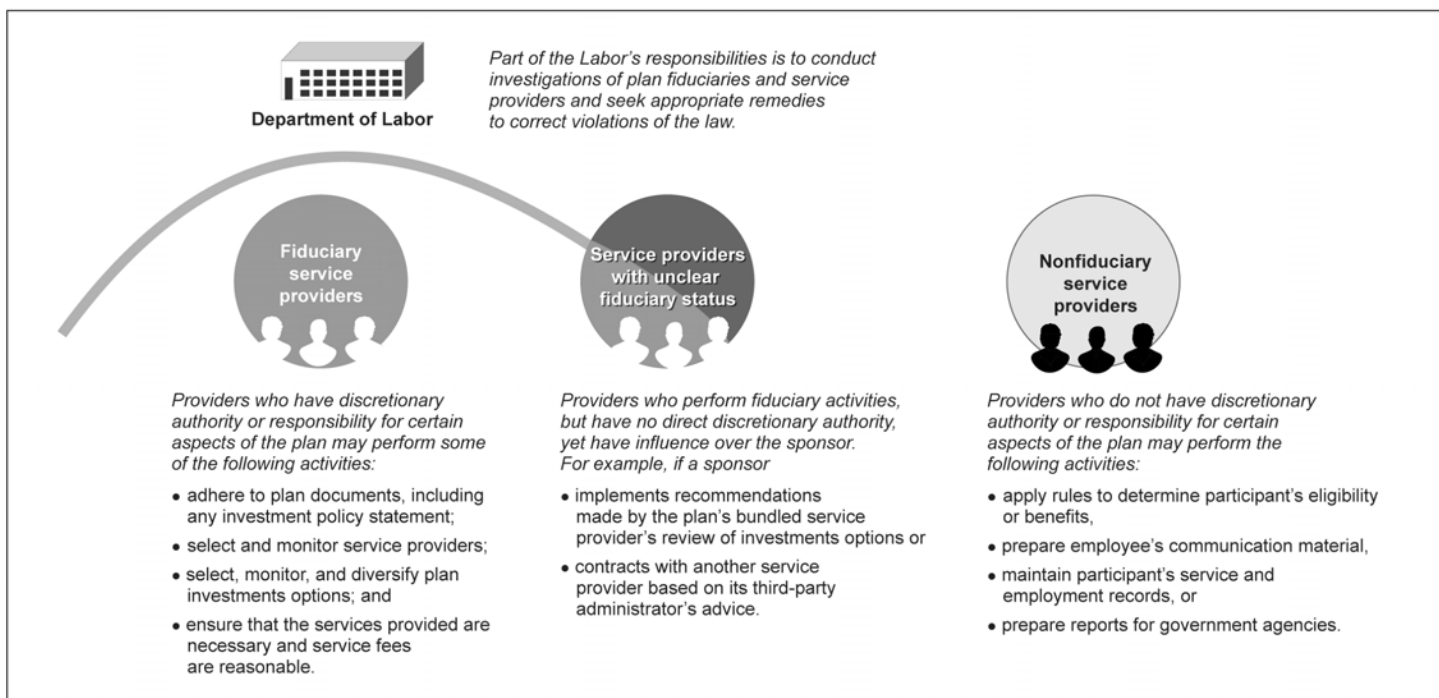
<sup>66</sup>ERISA requires that at least one fiduciary be named in the plan documents, which is typically the plan sponsor, but others may be identified. Plan sponsors may share or delegate certain fiduciary roles with their service providers, which can contribute to the confusion if roles are not well defined in these instances. In some cases, determination of fiduciary status may not be made unless a lawsuit is filed claiming that the plan has been harmed. While Labor is charged with enforcing the fiduciary standards required under Title I of ERISA, its authority over providers that are not determined to be acting in the capacity of an ERISA fiduciary is limited. For the proposed regulation, see Definition of the Term "Fiduciary," 75 Fed. Reg. 66263 (Oct. 22, 2010)(to be codified at 29 C.F.R. pt. 2510).

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including some investment advisers, are not considered to be plan fiduciaries by plan sponsors, according to information on our survey.

We also found that some sponsors relied on providers, who may not be considered plan fiduciaries under current regulations, to perform fiduciary functions, which can lead to gaps in plan oversight. As shown in figure 13, service providers who perform certain activities could be considered ERISA fiduciaries, and thus under the authority of Labor; however there are circumstances that may result in an unclear fiduciary role. During the course of our review, we found instances in which plan fiduciary roles were unclear. For example, we met with a sponsor of a small plan that told us the plan relied on its bundled provider to the extent that the sponsor considered the provider a plan manager and never felt the need to negotiate plan fees, because the sponsor trusted that the provider's representatives would let the sponsor know if the plan was being overcharged. This sponsor also told us that the provider's representative was always very clear that the information provided was not investment advice, and therefore the provider may not be considered an ERISA fiduciary. In another instance, a sponsor told us that the selection of the plan's investment provider was based on the recommendation of the plan's third-party administrator, whose fiduciary status was unclear.

**Figure 13: Examples of Activities Performed by Some Service Providers That May or May Not Be Considered ERISA Fiduciaries and Labor’s Role with Respect to These Service Providers**



Source: GAO analysis of federal laws and Department of Labor regulations.

Note: ERISA requires that plan documents identify one or more named fiduciaries, typically plan administrators and trustees. Aside from these named fiduciaries, the determination of fiduciary status is a facts and circumstances determination. Title I of ERISA gives Labor the primary authority to enforce requirements governing the conduct of fiduciaries of pension and other employee benefit plans. Our prior work indicates that the existing law limits Labor’s ability to pursue certain service providers that are not fiduciaries under ERISA.

Nonetheless, unclear fiduciary roles can lead to gaps in plan oversight. We previously reported that Labor generally would not be able to take action against a provider that was not considered a fiduciary under ERISA, and even in instances in which the courts have allowed Labor to pursue nonfiduciaries that contribute to a fiduciary breach, Labor officials noted that remedies were limited.<sup>67</sup> These limitations are further exacerbated by the fact that, as our survey shows, in the current retirement market, sponsors heavily rely on providers that may not be

<sup>67</sup>GAO, *Defined Benefit Pensions: Conflicts of Interest Involving High Risk or Terminated Plans Pose Enforcement Challenges*, [GAO-07-703](#) (Washington, D.C.: June 28, 2007).

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considered plan fiduciaries to help them manage their plans. Therefore, in addition to Labor's ongoing effort to amend the definition of an ERISA fiduciary, Labor may need to conduct a separate evaluation of relationships between sponsors and providers, whose fiduciary status is unclear. Such an evaluation may help Labor better oversee providers that may knowingly or unknowingly charge sponsors and participants higher fees than are necessary.

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## Conclusions

While some of our fee estimates are not representative of all 401(k) plans, our results indicate that small plans, which account for the majority of 401(k) plans, pay higher fees for a number of reasons. Our previous work on issues related to retirement plan sponsorship among small employers indicated that starting and maintaining a plan can be challenging. Some small plan sponsors are overwhelmed by the various administrative and fiduciary responsibilities and use service providers to help manage their plans, which can be costly. Regardless of plan size, many of these fees charged in 401(k) plans are passed along to plan participants, which ultimately results in reduced retirement savings. In this regard, plan sponsors may need to be aware of and closely monitor the fees charged by various service providers to help ensure the fees they and their participants pay are not excessive. However, in several instances, sponsors of large and small plans did not know or fully understand the fees charged to their plans, because fee arrangements have become so complex and may be disclosed differently, adding to sponsor confusion about plan fees. In addition, because sponsors of plans of all sizes may not be aware of certain fees that participants are paying, such as transaction costs and wrap fees, it is difficult to get a clear understanding of the total fees that participants are actually paying.

Labor has taken actions to help educate plan sponsors and provide them with complete information about fees, but our survey shows that Labor's efforts are not reaching its target audience. While Labor's service provider disclosure regulation is likely to provide plan sponsors with information to help them assess the reasonableness of fees received by plan service providers, our survey results show that sponsors whose providers are already disclosing revenue sharing arrangements have trouble understanding the impact of these arrangements on plan fees. Furthermore, sponsors in our survey had more than one provider and will likely receive multiple disclosure statements under the new regulation. Thus, more disclosures from multiple service providers about their fees may not be enough to ensure sponsors, and ultimately participants, are paying the most appropriate fee for plan services if they do not fully

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understand how certain arrangements work. By taking a more proactive approach to its educational outreach efforts, thereby ensuring its efforts are more effective at reaching plan sponsors, particularly those of small plans, who may lack the in-house expertise and resources necessary to manage their plans, Labor can increase the awareness of how fees are charged under complex arrangements and reduce the likelihood that sponsors and participants pay higher fees than necessary.

Although the Form 5500 was not intended to be a comprehensive database of plan fees, it could be a valuable source of information for sponsors to help them compare the fees they pay with those paid by other plans of similar size. Without enhancements to Labor's website, such as search functions for multiple purposes and different audiences, it will be difficult for users, namely plan sponsors, to use Form 5500 data, if they so choose, to compare the fees charged by service providers. Labor has a unique opportunity to make the information it collects available to sponsors in a way that will help them compare and negotiate their fees. In the absence of better access to high-quality plan fee information, sponsors will continue to rely on service providers for comparative fee information, which may or may not be unbiased. In addition, sponsors will continue to believe filing the form is onerous and not beneficial to them, because they cannot easily access and use it to determine fees.

Finally, our work shows that numerous providers have significant influence over sponsors and plan decisions but do not consider themselves to be fiduciaries, are not considered fiduciaries by plan sponsors, and may not be considered fiduciaries under Labor's proposed changes because they do not provide investment advice or have not already identified themselves as fiduciaries. In addition to Labor's ongoing efforts, an evaluation of the entire definition of the term "fiduciary" would be helpful to plan sponsors and service providers. Without an evaluation that considers the current structure of the retirement market, sponsors may continue to be unclear about the role of their providers. In addition, Labor may not have the ability to pursue service providers who have substantial influence over the plan and may seek to profit at the expense of the plan participants.

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## Recommendations for Executive Action

In order to help plan sponsors better understand how fees are charged to their plans and to help them make well-informed decisions, we recommend that the Secretary of Labor develop and implement alternative approaches to Labor's plan sponsor outreach and education initiatives that actively engage sponsors and allow the agency to track

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sponsor engagement. Such actions could include e-mailing sponsors about new regulations, guidance, and tools available on its website, and then monitoring website traffic and publication downloads to determine whether such initiatives are reaching their targeted audience.

To help sponsors better understand and monitor plan fees, including those paid by participants, Labor should enhance web access to publicly available fee information it collects on the annual Form 5500 to provide sponsors with information to compare and assess fees charged by service providers, such as building in the ability to search for and create customized reports of plans with similar features or providers for the purpose of benchmarking. It should also consider developing and posting key information, such as a data dictionary, about the publicly available Form 5500 datasets on its website, similar to the information distributed about the Form 5500 research files.

To help strengthen Labor's ability to oversee 401(k) plans, we recommend that in addition to Labor's ongoing efforts, Labor should evaluate whether individuals and service providers who exert significant control over the plan should be considered ERISA fiduciaries.

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## Agency Comments and Our Evaluation

We provided a draft of this report to Labor, the Department of the Treasury, and SEC for their review and comment. The Department of the Treasury did not have any comments. Labor and SEC provided technical comments, which we incorporated as appropriate. Labor also provided written comments, which are reproduced in appendix III.

In its written response, Labor generally agreed with our findings and recommendations. Labor appreciated our interest in improving awareness of plan fees and in ensuring that employers and other plan fiduciaries make more informed decisions with respect to the management of 401(k) plans. Labor noted that helping plan sponsors and participants obtain objective services at a fair price by enhancing the transparency of plan fees has been one of its highest priorities in recent years. Specifically, Labor cited the completion of three regulatory initiatives—(1) a regulation regarding the disclosure of service provider fee and revenue sharing arrangements, (2) disclosure of plan and investment-related information to participants and beneficiaries in 401(k)-type plans, and (3) changes to the information large plans must report about service provider compensation on the Form 5500—designed to augment and improve the disclosure of plan fee information at all levels. Labor was surprised that these initiatives were not highlighted more prominently in the summary

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section of the report. In fact, we outline these regulations in the background section of the report, discuss issues related to Labor's service provider disclosure regulation in the third section of the report, and summarize our overall assessment of Labor's regulatory actions on our highlights page. Labor also noted that the draft report did not include a substantive discussion of how these regulations are expected to address the issues raised in the report. Of the three regulations Labor noted, two—Labor's regulations regarding service provider disclosures to plan fiduciaries and disclosures to participants and beneficiaries—had not yet been implemented during our review, and therefore their effectiveness remains to be seen. With respect to the third regulation noted in Labor's written comments regarding changes to Schedule C of the Form 5500 Annual Report, which began with the 2009 plan year, our report and e-supplement describe these changes and how sponsors have used the additional information collected on the Form 5500. Our survey results show that the additional information collected on Schedule C provided some plan sponsors more useful information about their provider's compensation, but it did not help many sponsors negotiate plan fees nor did it result in the ability to compare fees paid with those charged by other service providers.

We commend Labor for quickly responding to our prior recommendation to finalize the regulation regarding disclosures of service providers' direct and indirect compensation from plan investments and Labor's efforts to collect information on a guide or similar requirement to assist plan sponsors in identifying and understanding the disclosures.<sup>68</sup> As we noted in the third section of this report, service provider disclosures under the new regulation may be difficult to understand, and multiple disclosures in different formats may further contribute to sponsors' confusion about plan fees. Labor shared our concerns about how plan fee information could be presented to sponsors and stated it will propose for public comment a supplement to the service provider disclosure regulation to fully address our previous recommendation.

Regarding our third objective, Labor appreciated our interest in EBSA's outreach and educational efforts on key fiduciary responsibilities, such as the fees paid for operating retirement plans. With respect to our recommendation on Labor's approach to plan sponsor outreach and

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<sup>68</sup>[GAO-11-119](#).



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education, Labor cited several ongoing efforts to engage sponsors and stated that it is exploring new ways to reach plan sponsors. We commend Labor for its efforts to provide educational information to the public; host webcasts on complex topics, such as its new fee regulations; and work with stakeholders, such as the Small Business Administration, to reach plan sponsors with its limited resources. However, throughout the section we illustrate through various survey results that Labor's efforts are not currently reaching its target audience. Specifically, our survey results show that sponsors of more than 90 percent of 401(k) plans either did not use or did not know about Labor's resources. We recognize that reaching sponsors may be challenging, but attempts to directly reach sponsors and help ensure they are considering all the relevant information when making plan decisions will be even more important as Labor's regulatory changes take effect. Consequently, we continue to believe new approaches to outreach are needed to help educate sponsors about complex fee arrangements and ensure sponsors and participants do not pay higher fees than necessary.

With respect to our findings on the availability of Form 5500 data, Labor shares our interest in making the data collected accessible to the public. Regarding our recommendation that Labor provide additional documentation to help users of the unedited Form 5500 data, Labor plans to explore the implementation of our recommendation. With respect to our recommendation that Labor enhance web access to facilitate sponsors' ability to compare and benchmark fees, Labor noted that a web tool for these purposes would have a limited effectiveness because of some inherent limitations to the Form 5500 data. Our report also outlines limitations with the data including the fact that not all plan fees are explicitly reported on the Form 5500. However, we continue to believe that the fee information collected could help sponsors monitor and compare fees. Additionally, while Labor also noted that it believes its new fee disclosure regulations will be a better tool for expanding transparency and encouraging informed comparison shopping by plan fiduciaries, as we previously noted, the effects of these regulations remain unclear. Furthermore, although Labor notes that the Form 5500 was not designed to be a government database for evaluating compensation arrangements in the pension plan market, it remains the primary and most comprehensive source of information on U.S. private pension plans and could be more effectively used to help sponsors. Thus, we reaffirm our recommendation to enhance web access to publicly available Form 5500 data.

Finally, with respect to our findings about the fiduciary status of service providers, Labor stated that it appreciated our support for its recent effort

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to update its rule defining the persons who are investment advice fiduciaries under ERISA. Regarding our recommendation to evaluate the types of individuals who should be considered ERISA fiduciaries, Labor agreed that there are individuals and service providers who exert significant control over plan decisions and should be held accountable for the advice they provide as fiduciaries. Labor noted that this regulatory initiative continues to be a high priority and that the agency plans to craft a clear and workable regulation that provides the strongest possible protections to individuals as well as to plan sponsors who offer retirement plans for their workers. While our review focused on plan sponsors, we recognize that 401(k) plan participants generally make investment decisions for their own accounts and ultimately pay the vast majority of plan fees. Therefore, we also agree with Labor's position that the absence of adequate fiduciary protections and safeguards is particularly problematic for plan participants.

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As arranged with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies to the Secretary of Labor, the Secretary of the Treasury, and the Chairman of the Securities and Exchange Commission. In addition, the report will be available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff have any questions concerning this report, please contact me at (202) 512-7215 or [jeszeckc@gao.gov](mailto:jeszeckc@gao.gov). Contact points for our Office of Congressional Relations and Office of Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix IV.



Charles A. Jeszeck  
Director, Education, Workforce  
and Income Security

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# Appendix I: Objectives, Scope, and Methodology

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On the basis of our research objectives, we obtained information on fee amounts paid by sponsors and participants for services, examined challenges sponsors faced in understanding how fees are charged, and identified actions the Department of Labor (Labor) has taken to help sponsors understand and monitor fees. We conducted this performance audit from October 2010 to April 2012, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

To answer our research objectives, we reviewed relevant federal laws and regulations pertaining to 401(k) fees and fee disclosure. We also reviewed available guidance provided by Labor, the Securities and Exchange Commission (SEC), and industry research related to understanding and disclosing fee information. We interviewed Labor, SEC, and Internal Revenue Service officials; industry experts; plan sponsors; and service providers to learn about current and proposed regulations and the requirements governing the disclosure of fee information as well as factors that affect the amount of 401(k) fees that can be charged to sponsors and participants.

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## Survey of 401(k) Plan Sponsors

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### Overview

We also surveyed plan sponsors to obtain information regarding their plans from calendar year 2010, such as the fee amounts paid for certain services, the factors they considered in selecting service providers, the investments offered to plan participants, and Labor resources they may have used, among other things. We conducted our survey using mail and electronic distribution from May 2011 to September 2011. To encourage survey participation, we obtained permission from our congressional requesters to remove links in our paperwork between individuals' identities and their responses. We informed sponsors of this agreement in the introductory letter transmitted with the survey. A copy of the questionnaire and survey responses for most questions is available in the e-supplement to this report, [GAO-12-550SP](#). The practical difficulties of conducting any survey may introduce errors, commonly referred to as

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nonsampling errors. For example, difficulties in interpreting a particular question or sources of information available to respondents can introduce unwanted variability into the survey results. We took steps in developing the questionnaire, collecting the data, and analyzing them to minimize such nonsampling error (see below).

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## Sample Design and Survey Pretesting

In order to capture information from plans of all sizes, we identified the population of 401(k) plans using Form 5500 filings submitted for plan year 2009, which resulted in approximately 468,000 unique active plans. We used Form 5500 data because they are the primary data source of information about the operations, funding, and investments of approximately 800,000 retirement and welfare benefit plans. We chose to use the Form 5500 dataset for the 2009 plan year because it was the most current and accurate available as of January 2011. For details on our methodology for identifying the population of 401(k) plans and assessing the reliability of Form 5500 data, see appendix II. We drew a representative sample of 1,000 401(k) plans from the 2009 population. We stratified our sample based on the number of participants reported at the beginning of plan year 2009 into five groups: fewer than 10 participants, 10-49 participants, 50-99 participants, 100-499 participants, or 500-plus participants. This stratification emphasized smaller plans because a majority of plans in the 401(k) plans universe have fewer than 500 participants. Although our sample was grouped into five strata, for the purposes of comparison and to help increase the statistical power of our estimates, we analyzed survey results by three groups: fewer than 50 participants (small), 50 to 499 participants (medium), and 500 or more participants (large). We defined “small,” “medium,” and “large” for the purposes of our report, as there is no industrywide definition.

To inform the design of our survey instrument, we reviewed surveys conducted by companies and industry organizations and met with them to gain a better understanding of their methodology and any limitations. In addition, for each of our five strata, we conducted two to three in-person and telephone pretests with plan sponsors in four geographically different areas representing an array of businesses for a total of 13 pretests to ensure that survey questions were collecting the expected information, obtain any suggestions for clarification, and determine whether sponsors would be willing to provide fee information.

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## Efforts to Minimize Response Bias

For the 1,000 plans in our sample, we contacted the individuals who signed the Form 5500 as the plan sponsor or plan administrator, because these individuals are generally responsible for, or serve on the committee responsible for, selecting a 401(k) plan's investment options or service providers, among other key plan decisions that affect plan fees. To help ensure the plan was still within the scope of our review and that the identified individual was the appropriate survey respondent to complete the survey, we contracted with a survey research firm to call sampled sponsors to confirm the name and contact information of the target. Contractor staff used a call script, which we drafted, and included questions about whether the plan was still active. The script also included several screening questions to help determine whether our identified target was the appropriate survey respondent. These questions were as follows:

- Are you or a committee you serve on responsible for selecting the companies that provide services such as recordkeeping, financial advice, or managing securities, for your 401(k) plan?
- Are you or a committee you serve on responsible for selecting the menu of investment options for your company's 401(k) plan?
- Are you or a committee you serve on responsible for handling non-investment decisions for your company's 401(k) plan, such as the level of the employer match and rules about loans, vesting, and coverage?

We included these questions to help ensure that a person knowledgeable about the plan received the survey and reduce the likelihood of response bias being introduced by nonfiduciaries completing the survey. We determined that if a target did not respond affirmatively to at least two of three questions, then contractor staff should attempt to collect the name and contact information for an alternative target. If contractor staff were able to connect with the alternative target, the screener questions were again asked. Once the survey had been fielded, contractor staff conducted follow-up calls using a script to confirm that the target had received the survey and encourage participation. As with the first round of calling, the script included questions geared toward verifying the plan was still active and that the appropriate target received the survey. Inactive plans were considered to be out of scope for this survey.

## Analysis of Respondents

As summarized in table 5, we obtained questionnaires from 365 respondents, for an overall weighted response rate of 39 percent. We conducted a nonresponse bias analysis to see if the characteristics of survey respondents generally reflected population characteristics, such as plan size (i.e., the total number of participants), total plan assets, geographic distribution, and nature of business. We initially used variables available in the Form 5500 data to look at plans' propensity to respond to the survey. We looked at a couple of models, but found that the stratification variable did as good a job of predicting response as the other models. The differences between the models were not substantively significant. The number of participants is the basis of our stratification variable and a significant factor for the propensity of response. We assumed that the nonrespondents were missing at random within each stratum and used the strata as nonresponse adjustment cells. The results of our analysis enable us to generalize our results to the total population of 401(k) plan sponsors for most survey questions. All percentage estimates from the survey have margins of error at the 95 percent confidence level of plus or minus 8 percentage points or less, unless otherwise noted.

**Table 5: 401(k) Plan Survey Sample and Response Rates**

Number of plan participants	Population	Number of cases selected	Response	Out of scopes <sup>a</sup>	Weighted response rate (percentages) <sup>b</sup>
Fewer than 10 participants	149,783	234	70	33	41
10-49 participants	205,138	233	84	24	39
50-99 participants	56,071	233	81	14	27
100-499 participants	44,928	150	60	8	40
500 or more participants	12,274	150	70	8	44
<b>Total sample</b>	<b>468,194</b>	<b>1,000</b>	<b>365</b>	<b>87</b>	<b>39</b>

Source: GAO.

<sup>a</sup>A total of 87 plans in our sample were determined to be out of scope for this survey, generally because a plan was no longer active or the company sponsoring the plan appeared to be no longer in business after several attempts to call or locate new contact information.

<sup>b</sup>For respondents, we used their answers to a survey question asking the number of participants in the 2010 calendar year for these calculations.

We also conducted integrity checks of answers across questions and enforced skip patterns, when appropriate. As a result of this review, we re-categorized the type of information provided by some sponsors when their responses were inconsistent. For example, if a sponsor did not

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respond to the question asking whether the plan paid recordkeeping and administrative fees, but in a subsequent question listed amounts paid or that were taken out of plan assets for recordkeeping and administrative services, we determined it was reasonable to categorize the plan as having paid these fees.

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## Fee Estimates

To compare fees reported for (1) recordkeeping administrative services, (2) investment management, (3) retirement plan consulting and investment advice, and (4) other fees, we generated estimates of the amounts paid by plan sponsors and participants. We calculated our estimates as a percentage of plan assets and on a per participant basis using the annual amounts reported by sponsors for each service, plan assets, and number of plan participants for calendar year 2010. We calculated fee estimates by each service type, instead of calculating an overall fee amount, because only 14 of our 365 survey respondents provided amounts for all of the services. When generating our estimates of the amounts paid by sponsors for a particular service, we excluded a sponsor's response if

- the value for the amount that the sponsor paid was missing;
- the sponsor indicated that it did not know the amount paid by reporting a value of "1" per survey instructions; or
- the value for plan assets or number of plan participants was missing, since these were needed to estimate fees as a percentage of assets and on a per participant basis, respectively.

Similarly, when generating our estimates of the amounts paid by participants for a particular service, we excluded a sponsor's response if

- the value for the amount that participants paid was missing;
- the sponsor indicated that it did not know the amount paid by participants by reporting a value of "1" per survey instructions; or
- the value for plan assets or number of plan participants was missing, since these were needed to estimate fees as a percentage of assets and on a per participant basis, respectively.

In addition, we also exclude respondents who indicated their fees were waived or the amount the sponsor paid was zero when reporting ranges

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and averages to more accurately represent the fees deducted from plans and plan participants.

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## Analysis of Supplemental Documents

As part of our analysis of sponsors' understanding of how fees are charged to plans, we analyzed documents that sponsors submitted with their survey responses. Of the 365 plan sponsors who responded to our survey, 163 provided copies or successfully uploaded documents for our request for a summary of all investment options and the fees associated with each option. We reviewed the documents provided to determine if their plans paid revenue sharing fees, such as 12b-1 or sub-TA fees, and wrap fees associated with insurance products. We also reviewed investment fund prospectuses associated with the investment options included in the documents sponsors submitted to determine if their plans paid these fees.<sup>1</sup> Finally, for respondents for whom data were available, we reviewed fee reports generated by a third party, BrightScope, to determine the fees associated with transaction costs for individual investment options. BrightScope calculates estimates of 401(k) plan fees by drawing on publicly available data, primarily Form 5500 filings.<sup>2</sup> BrightScope fee data are limited to plans with more than 100 participants, because the data's main source is Form 5500 Schedule H—Financial Information, which includes independently audited information, and plans with fewer than 100 participants are generally not required to file this schedule. We took actions to determine whether the BrightScope data were sufficiently reliable for our purpose of describing the range of transaction costs incurred by 401(k) plan participants by interviewing company representatives and reviewing the methodology used to develop estimates.

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<sup>1</sup>Presently, funds must provide investors with written disclosures about the fund in a prospectus that must be provided to investors when they purchase shares. According to SEC, under federal securities laws, a fund can satisfy its prospectus delivery obligation by providing its prospectus to the plan (without having to provide the prospectus to participants). SEC rules require that the prospectus include a fee table containing information about the sales charges, operating expenses, and other fees that investors pay as part of investing in the fund.

<sup>2</sup>BrightScope is a financial information company that services U.S. plan sponsors, advisers, providers, and participants. BrightScope maintains a database of information on 401(k) plans, which it uses to quantitatively rate plans across a number of metrics, including total plan fees, quality of investment menu options, and plan participation. BrightScope used publicly available data from various sources, including Form 5500 filings, SEC, the U.S. Census Bureau, and the Bureau of Labor Statistics to help develop and maintain its database.



In conducting a review of fees and analysis of supplemental documents, it was not the purpose, nor does GAO purport, to identify situations or circumstances in this report where plan sponsors or fiduciaries may have breached their fiduciary duties. Determining whether a fiduciary breach has occurred is based upon the facts and circumstances of each case. Our follow-up with plan sponsors was not aimed at reaching this determination. Therefore, our findings should not be read as indicating a breach of fiduciary or other obligation.

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# Appendix II: Identification of 401(k) Universe and Assessment of Form 5500 Data

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To identify our study population of 401(k) plans, we obtained the most current and complete Form 5500 Annual Reports/Filings from Labor, which as of January 2011 were plan year 2009 data. We used Form 5500 data because they are the primary data source of information about the operations, funding, and investments of approximately 800,000 retirement and welfare benefit plans. During our initial meeting with Labor officials on November, 30, 2010, the most complete dataset available was for plan year 2007 and plan year 2008 data would be available in the spring of 2011. However, according to Labor officials, 2008 data are the least accurate and reliable of years 2007, 2008, and 2009—with 2009 being the most accurate. By January 2011, about 85 percent of the expected filings for 2009 were received and validated. The main reason that Labor has not received the remaining 15 percent of expected filings is because plans can have later beginning and ending plan dates (i.e., December 30, 2009-December 31, 2010) and therefore are not yet required to file. For example, if a plan's begin date is December 31, 2009, and end date is December 31, 2010, the normal statutory deadline to file would be July 31, 2011. Labor officials suggested that we supplement incomplete 2009 filings with 2008 filings. On the basis of testimonial evidence from Labor officials and representatives from other entities that regularly use Form 5500 data, and our review of key variables, we determined that the 2008 data were not sufficiently reliable for our purpose of identifying the population of 401(k) plans for a single year.

To assess the reliability of Labor's data, we (1) performed electronic checking for errors in accuracy and completeness; (2) reviewed related documentation, such as the system's Data Element Requirements; and (3) held numerous meetings and remained in ongoing correspondence with Labor to discuss data fields and analysis procedures. When we found inconsistencies, for example, between the data and information Labor officials told us about the structure of the file, we clarified them with Labor. For example, during our interviews with Labor, we learned that the unedited Form 5500 datasets contained duplicate filings for unique plans (with a unique combination of an Employer Identification Number [EIN] and plan number), because filers may amend their returns and, for data file pre-2009, steps would need to be taken to identify the most current filing. After clarifying and resolving our questions pertaining to the data,

we concluded that the 2009 dataset was reliable for the purpose of identifying the population of 401(k) plans.<sup>1</sup>

In using plan year 2009 data, we had to merge data filed from filers of the normal Form 5500, and the Form 5500-SF (Short Form) filings for small plans—generally plans with fewer than 100 participants—that choose to file the new shorter form.<sup>2</sup> Our analysis also included a review of plan assets, which are filed in Schedule H—Financial Information for plans with 100 or more participants at the beginning of the plan year and Schedule I—Financial Information—Small Plan for plans with fewer than 100 participants.<sup>3</sup> Because data filed for schedules are stored separately, financial information for plans also had to be merged before we could conduct our analysis of the data.

For the purposes of this report, we defined our study population as unique single-employer-sponsored 401(k) plans. On the basis of discussions with Labor officials, a unique plan is defined by a unique combination of a plan's Employer Identification Number and plan number, because private sector companies may have more than one plan. We also took the following steps to edit the data:

**Excluded other plan year filings:** We first checked for and removed records in the dataset that were not for the 2009 filing year. Labor accepts and processes Form 5500 filings as companies submit information, which could be for an earlier plan year, but included in a different year's Form 5500 dataset.

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<sup>1</sup>With the implementation of the ERISA Filing Acceptance System 2 (EFAST2), Labor began posting the electronic files in two forms: All and Latest. The dataset listed as "All" includes all filings received by Labor without regard to filing status or the number of attempts to file. This dataset may contain multiple filings for a single plan. The dataset listed as "Latest" includes only the latest, most correct filing for a plan. We downloaded 2009 "Latest" dataset on March 7, 2011 to identify the 401(k) universe.

<sup>2</sup>On November 16, 2007, Labor finalized regulations that established a new Short Form 5500 to help reduce and streamline the reporting requirements for certain small pension plans (generally plans with fewer than 100 participants) that meet certain conditions regarding their investments being held or issued by regulated financial institutions and have a readily determinable fair market value. The use of the Short Form 5500 was not made available for filing until the implementation of the fully electronic filing system, known as EFAST2.

<sup>3</sup>For plans that filed using the Form 5500-SF, we used the plan asset information incorporated into the form.

**401(k) plans:** Because the scope of the job focuses on 401(k) plans and not other pension plans, such as defined benefit plans, we created a subset of the data for only 401(k) plans by reviewing records in which the filer indicated “2J” as a pension feature. Labor officials recommended that we review the plan name for variations of 401(k), such as “401(k)” or “401k”, because some filers do not correctly complete or update their pension feature codes, a recommendation that we incorporated into our design.

**Single-employer plans:** We exclude multiemployer plan and multiple-employer plan filers, because these plans are maintained by more than one employer for special groups such as labor unions and are typically managed by going to another source for a pension plan model. We removed records for plan filers that were not single-employer plans—multiemployer, multiple-employer, and direct filing entity.

**Final return:** Last, we dropped plans in which the filer indicated that the report was the final return/report. We assume a final return indicates that the plan is no longer active. The establishment sponsoring the plan could have gone out of business or the plan may have been rolled over as a result of an acquisition or merger.

Our analysis yielded a population of more than 468,000 active unique single-employer-sponsored 401(k) plans for plan year 2009; see the table below for additional details.

**Table 6: 401(k) Plan Characteristics, 2009**

(Dollars in millions)

Number of plan participants	Number of plans	Participants	Total plan assets	Average account balance
Fewer than 100	410,992	9,456,007	\$367,174	\$38,830
100 or more	57,202	53,497,737	2,032,956	38,000
<b>Total</b>	<b>468,194</b>	<b>62,953,744</b>	<b>\$2,400,130</b>	<b>\$38,125</b>

Source: GAO analysis of 2009 Form 5500 filings/returns.

# Appendix III: Comments from the Department of Labor

U.S. Department of Labor

Assistant Secretary for  
Employee Benefits Security Administration  
Washington, D.C. 20210



Mr. Charles A. Jeszeck  
Director, Education, Workforce, and Income Security  
United States Government Accountability Office  
Washington, DC 20548

Dear Mr. Jeszeck:

Thank you for the opportunity to review the Government Accountability Office's (GAO) draft report entitled "401(k) Plans: Increased Educational Outreach and Broader Oversight May Help Reduce Plan Fees" (GAO-12-325). We appreciate GAO's interest in improving awareness of the fees paid by employee benefit plans, and in ensuring that employers and other plan fiduciaries make more informed decisions when selecting and monitoring plan service providers and investment options for plan participants and beneficiaries when managing their 401(k) retirement accounts.

In recent years, one of the highest priorities of the Employee Benefits Security Administration (EBSA) has been to help plan sponsors and participants obtain objective investment, recordkeeping, and other services at a fair price by enhancing the transparency of plan fees. In fact, EBSA recently completed a three-part regulatory program designed to augment and improve the disclosure of plan fee information at all levels. In February 2012, EBSA published the final "408(b)(2)" regulation (77 FR 5632), addressing the comprehensive disclosures that covered service providers must furnish to pension plan sponsors before they enter into contracts or arrangements for plan services. One of the fundamental goals of the 408(b)(2) regulation is to mandate detailed, clear disclosures by service providers of the often complex investment, recordkeeping, and other fees and revenue sharing arrangements discussed in your draft report. EBSA also published a final rule in October 2010 requiring the disclosure of plan and investment-related information, including fee and expense information, to participants and beneficiaries in 401(k)-type plans (75 FR 64910). This participant-level disclosure regulation will make it easier for an estimated 65 million participants in 401(k)-type plans to make informed retirement savings decisions. The regulation requires plan administrators to furnish workers with useful summary information, including fee and expense information, for investment options available under their plans. The centerpiece of the participant-level disclosure regulation is a requirement to provide this investment-related information in a comparative chart or similar format. Finally, EBSA previously implemented changes to the information that large plans must report beginning with the 2009 plan year about service provider compensation as part of the Schedule C (Service Provider Information) of the Form 5500 Annual Report (72 FR 64731).

EBSA also shares GAO's concerns as to *how* service provider fee information, potentially contained in documents from multiple sources or in lengthy service provider contracts, is presented to pension plan sponsors. Specifically, EBSA will soon propose for public comment a supplement to the 408(b)(2) regulation that would require covered service providers to furnish a guide, or "roadmap," to assist pension plan sponsors in reviewing the disclosures required by the

final rule.<sup>1</sup> This proposal is intended to solicit specific information and data from all interested parties about whether and how a guide (or similar requirement) may be cost-effectively structured to assist plan sponsors, especially in the case of small and medium-sized plans, in identifying and understanding the required service provider disclosures.

EBSA believes that this regulatory framework responds to many of the concerns discussed in your draft report. In fact, we were surprised that these initiatives were not individually mentioned in the summary section of your draft report, and that the draft report did not include a substantive discussion of how these regulations are expected to address many of the report's identified concerns. EBSA will continue to monitor and examine the impact of these new disclosure requirements on plan sponsor and participant decision-making, and on marketplace developments that may play a role in fee comparisons.

GAO, in relevant part, is recommending that EBSA take steps to assist employers and other sponsors of 401(k) and similar individual account pension plans better understand and monitor the fees that are charged to their plans and to improve EBSA's oversight of 401(k) plans. These steps include: (i) development and implementation of alternative approaches to its plan sponsor outreach and education initiatives that actively engage sponsors and allow EBSA to track sponsor engagement; (ii) enhancement of Internet web access to publicly available fee information that is collected in the Annual Report Form 5500 to enable plan sponsors to compare and assess service provider fees; and (iii) evaluation of whether individuals and service providers who exert significant control over the plan should be considered ERISA fiduciaries. In response to these specific recommendations, we submit the following:

#### ***Outreach and Education***

We appreciate GAO's interest in EBSA's outreach and educational efforts on key fiduciary responsibilities such as the fees paid for operating retirement plans. Since its launch in 2004, we have conducted 36 seminars as part of our *Getting It Right...Know Your Fiduciary Responsibilities* Campaign in 2004 to assist employers, particularly small businesses, in understanding their basic fiduciary responsibilities, including the selection and monitoring of plan service providers and investments. We have a dedicated publication available on our website as part of this Campaign, recently updated to reflect EBSA's new fee disclosure regulations, to help small businesses understand plan fees and expenses. A separate publication, similarly updated, provides an overview of basic fiduciary responsibilities and prominently features information related to fees. EBSA's compliance assistance web page, where these and other educational tools and publications are made available, is consistently among the top five pages viewed on the website and many of the Campaign publications are top ranking pages as well. Educational information is also provided through a variety of full and half-day seminars held around the country through EBSA's regional offices and through webcasts to reach those who cannot attend in person. Recent webcasts have focused on the new fee regulations and guidance, and another webcast is planned for later this year.

<sup>1</sup> See [www.reginfo.gov/public/do/eAgendaViewRule?pubId=201110&RIN=1210-AB53](http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201110&RIN=1210-AB53).

With respect to the recommendation to develop and implement alternative approaches to plan sponsor outreach and education and to actively engage and track sponsor engagement, this is something that EBSA continuously works to do despite very limited resources. We send blast emails to our website subscribers and key stakeholders, such as the Small Business Administration (SBA), and use our events and newsletters as an opportunity to encourage plan sponsors to subscribe to our website for automatic updates on new guidance and upcoming events. We also pull contact information for small businesses from Form 5500 filings to mail registration forms for upcoming seminars and events in their geographic locations. We have looked into using email addresses to reach small business plan sponsors for promoting our events (instead of mail). However, the email address available from the EFAST2 data is that of the plan administrator, who, for a small business sponsored plan, may be a service provider. This is why we work through stakeholders to reach their members as well as the SBA. A mailing to all small businesses with a plan would be cost prohibitive.

Creating awareness of EBSA and our educational campaigns is an ongoing challenge that we continue to work to address. We have new ideas on reaching plan sponsors that we are exploring and will be actively working to develop additional approaches. We also will continue to use the feedback we get from small businesses attending our events, reading our materials, visiting our website, and using our tools to improve the education we provide.

#### *Enhancement of Web-Based Information*

EBSA shares GAO's interest in making the data collected on the Form 5500 accessible to the public. As GAO noted, EBSA currently provides the Form 5500 Private Pension Plan Research Files, containing data that has been cleaned and checked to enhance accuracy. The research file is available to the public on-line. EBSA annually publishes a Pension User Guide for the Form 5500 Private Pension Plan Research Files (Pension User Guide), providing documentation for the Form 5500, and Schedules H and I. In addition, EBSA makes available with the Form 5500 Private Pension Plan Research File certain PDF documents which label the questions on the Form 5500 Forms and Schedules with their corresponding variable name in the data sets.

The transition to all electronic Form 5500 filings as of January 1, 2010, with the corresponding introduction of EFAST2, along with other new Form 5500 filing requirements has led to changes in the structure of the unedited Form 5500 data. EBSA is currently in the process of updating the Pension User Guide and expects to publish an updated edition in spring 2012. GAO is recommending that EBSA provide additional documentation that would help users of the unedited Form 5500 data. EBSA is exploring the implementation of this recommendation.

GAO's recommendation that EBSA enhance web access to facilitate plan sponsors' ability to compare and benchmark the fees that they are charged by service providers faces limitations inherent in the Form 5500 data collection. For example, small pension plan filers (those plans with fewer than 100 participants) are generally required to report a single aggregate number for all fees and expenses paid directly by the plan, whereas large pension plan filers report somewhat less aggregated information on Schedule H (Large Plan Financial Information) and Schedule C (Service Provider Information). The Schedule H contains aggregated service provider expense figures as part of the income and expense statement and the Schedule C includes more detailed

information on direct and indirect compensation received by plan service providers. For large plans that file the Schedule C, the Form 5500 includes codes that identify the services provided and the types of compensation received by those service providers that are required to be individually listed, but it does not require plans to report information on the specific services received in exchange for specific fees and expenses. Consequently, consistent comparisons across plans would be difficult and a web tool to compare and benchmark fees would have limited effectiveness. Furthermore, as we noted in our comments on GAO's Report 10-54 (Additional Changes Could Improve Employee Benefit Plan Financial Reporting, Nov 5, 2009), although the Form 5500 generally serves as a source of data for use by the government and private sector in assessing employee benefit, tax, and economic trends, and policies, the Schedule C was not designed with an eye toward creating a government data-base for evaluating and comparing compensation arrangements in the pension plan marketplace. The expanded Schedule C reporting requirements implemented in the 2009 Form 5500 tried to strike a balance between annual reporting costs and information benefits, and were intended to help ensure fiduciaries systems in place to collect information and evaluate service provider compensation. We believe our 408(b)(2) and 404 fee regulations are better tools for expanding transparency and encouraging informed comparison shopping by plan fiduciaries.

Nonetheless, EBSA has begun the process of providing better search and reporting functionality to Form 5500 filers through its ongoing maintenance activities. We are currently exploring, for example, enhancements to the EFAST2 web portal to support searches on items such as sponsor/admin state; zip code; plan features; benefit arrangements; funding arrangements; participants counts; assets; business codes; contributions; end of year assets; and service provider fees. These enhancements may also provide EFAST2 system users with the ability to create reports of plans. We are also exploring the possibility of providing such features through other EBSA applications. However, the scope, timing and delivery of this functionality are subject to availability of funding, and procurement/contractual constraints.

#### *Evaluation of ERISA Fiduciary Status*

EBSA appreciates GAO's support of the Department's effort to update its rule defining the persons who are investment advice fiduciaries under ERISA. EBSA agrees that individuals and service providers who provide advice and recommendations for a fee with respect to a plan's investment decisions exert significant control over those decisions and should be accountable for the advice they provide as fiduciaries. This initiative continues to be a high priority project for the Department. EBSA is working hard to craft a clear and workable regulation that provides the strongest possible consumer protections to individuals saving for retirement in employee benefit plans and IRAs as well as to plan sponsors who offer retirement plans for their workers.

In EBSA's view, ERISA's statutory language defining a fiduciary covers a broad category of investment advisers based on their functions with the intent of limiting their ability to engage in self-dealing and other conflicts of interest. Thus, whether a person is fiduciary under ERISA is a functional test. Such functional tests cannot be avoided by a person's agreements or disclaimers with the plan sponsor. The reproposal of the rule currently being developed will reflect this view and propose a definition of fiduciary investment advice that reflects the broad scope of the statutory text and its purposes and that protects plans, participants, beneficiaries, and IRA owners



from conflicts of interest, imprudence, and disloyalty on the part of those who provide paid investment advice. Today many persons who provide investment-related advice and recommendations, such as brokers, actually receive compensation from the financial institutions whose investment products they recommend. This gives the advisers a strong motivation to favor investments that provide them greater compensation rather than those most appropriate for their customers.

With the major shift to individual account plans noted by GAO, the absence of adequate fiduciary protections and safeguards is especially problematic because many of these plans require participants to make investment decisions for their own accounts. In such plans participants often must choose from among a great variety of investments, and may often need expert advice to protect and grow their retirement savings. The rule is necessary to properly align the regulatory definition of fiduciary with the statutory provisions and to ensure advisers' making investment recommendations for fees give impartial advice to plans, participants, beneficiaries or IRA owners.

In conclusion, we appreciate GAO's interest in helping plan sponsors understand the challenges of selecting and monitoring plan service providers and ensuring that only reasonable fees are paid for plan services. EBSA is committed to protecting the retirement benefits of workers, retirees, and their families. Please do not hesitate to contact us if you have questions concerning this response or if we can be of further assistance.

Sincerely,



Phyllis C. Borzi  
Assistant Secretary

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# Appendix IV: GAO Contacts and Staff Acknowledgments

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## GAO Contact

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## Acknowledgments

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