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BEFORE THE

ADVISORY COUNCIL ON EMPLOYEE WELFARE AND PENSION BENEFIT
PLANS

DEPARTMENT OF LABOR

ON

FEE AND RELATED DISCLOSURE TO 401(K) PLAN PARTICIPANTS

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EXECUTIVE SUMMARY

Millions of Americans rely on their 401(k) plans to provide for their retirement security, yet current disclosure rules do not provide them with adequate information about plan fees and other topics that they need to make informed investment decisions. The Department of Labor should develop a uniform disclosure document for 401(k) plans that uses the mutual fund profile (including particularly the mutual fund fee table) as a guideline. The 401(k) plan disclosure document should provide a short, standardized, easy-to-read summary of key information about the plan and should be required to be delivered to all plan participants. Such disclosure would enable 401(k) plan participants to make more informed investment decisions and reduce plan costs by promoting competition.

I. Introduction

Members of the Advisory Council, thank for you the opportunity to address the Council today. It is a privilege to be asked to assist the Council in its important work on behalf of working Americans.

I applaud the Council for addressing the issue of 401(k) fee disclosure. Over the last year, there has been a great deal of debate, often quite heated, although quite bipartisan, about the disclosure of mutual fund fees. Fee disclosure is a challenging and important topic that plays a critical role in Americans' ability to plan for their retirement security.

The mutual fund debate has, unfortunately, involved relatively little discussion about exactly what purpose fee disclosure should serve. Yet this is precisely where any discussion about fee disclosure should begin. As a general matter, before the government intervenes in the marketplace, it should define its goals and the reason that government intervention is needed to achieve them.

The purpose of government-mandated fee disclosure, in my view, should not be to regulate fees, but to draw investors' attention to the importance of fees in achieving their investment goals. Achieving this goal promotes individual freedom, by enabling investors to make informed investment decisions that reflect their own evaluation of their 401(k) plans and the merits of different investment options within those plans. Drawing investors' attention to fees also promotes price competition by stimulating a dynamic engagement between buyers and sellers with respect to the cost and scope of the services and products being sold.

Government intervention is needed because free markets are, in many respects, inefficient with respect to the disclosure of material information. The issue of government-mandated disclosure requirements has been hotly debated for decades, and a full treatment of the issue of government-mandated disclosure is beyond the scope of this

discussion. Suffice it to say that this author believes that government-mandated standardized fee disclosure increases Americans' wealth and freedom, both by enabling Americans to make fully informed investment decisions and reducing costs by creating price transparency for many types of products.

With these broad goals in mind, this Testimony considers the disclosure of 401(k) plan fees, with a prefatory section on fee disclosure by mutual funds. To a large extent, mutual fund fee disclosure rules form the basis of 401(k) fee disclosure rules because: (1) mutual funds are a common investment option for 401(k) plans,¹ (2) investment options comprise the bulk of 401(k) plan expenses,² and (3) plan sponsors relying on the Section 404(c) safe harbor must provide participants with the mutual fund prospectus.³ The principal fee disclosure received by millions of 401(k) plan participants therefore is effectively dictated by SEC rules and may be materially affected by proposed changes to such rules. Current mutual fund fee disclosure rules and pending proposals are discussed in Part II of this Testimony. Part III of this Testimony discusses fee disclosure in the context of 401(k) plans.

II. Mutual Fund Fee Disclosure

Mutual funds are required to disclose their fees in a fee table in the prospectus (see Exhibit A for an illustrative fee table). The prospectus generally must be provided to investors shortly after the purchase if they use a broker or other intermediary (hereinafter, "broker"), and at the time of or before the purchase if they invest directly in the fund. As discussed further below, the Securities and Exchange Commission ("SEC" or

¹ See Mutual Fund Fact Book 2004, Investment Company Institute at 92 (48% of 401(k) assets were invested in mutual funds at the end of 2003) available at http://www.ici.org/stats/mf/2004_factbook.pdf.

² See Understanding Retirement Plan Fees and Expenses, Employee Benefits Security Administration, Department of Labor at 3 (May 2004); Proposed Legislation Call for Better Fee Disclosure – Do You Know How Fund Fees Impact Your 401(k) Plans? Hewitt Associates (Feb. 10, 2004) (investment management costs comprise 70% of total plan costs) available at <http://was4.hewitt.com/hewitt/resource/newsroom/pressrel/2004/02-10-04.htm>.

³ See supra discussion at Part III(b).

“Commission”) has proposed to amend its rules to require delivery of mutual fund fee information before the purchase even when the investor uses a broker.⁴

The mutual fund fee table divides the costs of investing into two categories: shareholder fees and operating expenses. Shareholder fees are based on the shareholder’s particular account. These include distribution fees such as front-end and back-end sales charges, which are paid to the fund’s underwriter and the shareholder’s broker, and redemption fees, which are paid to the fund to compensate the fund primarily for the cost of buying and selling portfolio securities and typically apply only to short-term holdings. Shareholder fees also include fees charged for exchanges between funds and fees charged on a per account basis, such as fees for small accounts. The latter are typically disclosed in a footnote or caption to the fee table.

Some shareholder fees are disclosed as a percentage of assets, and others as a dollar amount. Front-end and back-end sales loads are disclosed as a percentage of the fund’s offering price, that is, as a percentage of the total amount paid by the shareholder, not the total amount ultimately invested in the fund.⁵ The fee table shows the maximum sales load.⁶ Redemption fees are also disclosed as a percentage of assets. Small account fees are typically stated as a flat dollar amount that is payable once an account falls below

⁴ See infra discussion at Part II(a).

⁵ The Commission has proposed to require that front-end and back-end sales loads be shown in the prospectus as a percentage of the total amount invested in the fund. See Confirmation Requirements and Point of Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, and Other Confirmation Requirement Amendments, and Amendments to the Registration Form for Mutual Funds, Investment Company Act Rel. No. 26341 (Jan. 29, 2004) (proposing release).

⁶ If the fund offers discounts sales loads for large purchases, a schedule of such discounts, commonly referred to as “breakpoints,” must be provided in the prospectus. The Commission, National Association of Securities Dealers, and the New York Stock exchange conducted inspections between November 2002 and January 2003 that revealed that in one-third of the cases in which shareholders were entitled to a discount, they did not receive it. See Joint SEC/NASD/NYSE Report of Examinations of Broker-Dealers Regarding Discounts on Front-End Sales Charges on Mutual Funds at Part V.B (March 2003). Among other measures, the Commission recently amended its rules to improve disclosure of information about breakpoints. See Disclosure of Breakpoint Discounts by Mutual Funds, Investment Company Act Rel. Nos. 26298 (Dec. 17, 2003) (proposing release) & 26464 (June 7, 2004) (adopting release) (requiring new disclosure to appear in filings on or after Sep. 1, 2004).

a certain amount. A common cutoff for small account fees is \$10,000, and might equal about \$10, or 0.2% of assets for a \$5,000 account.⁷

Operating expenses, the second category of fees in the fee table, are divided into three line items: management fees, 12b-1 fees, and “other expenses.” Management fees are typically fees paid to the fund portfolio manager for portfolio selection and trading services, and sundry administrative services, such as pricing the fund’s portfolio. 12b-1 fees are fees charged pursuant to a 12b-1 plan adopted under Rule 12b-1 under the Investment Company Act. These fees are used primarily as selling compensation for brokers, often in lieu of front-end or back-end loads. A substantial part of 12b-1 fees also may be used for certain administrative services, such as sub-accounting services provided by brokers. “Other expenses” typically are administrative fees not otherwise picked up by management or 12b-1 fees.

The term “operating expenses” is somewhat of a misnomer, as some of these fees are actually used not for operating the fund, but for distributing its shares. As already stated, operating expenses include 12b-1 fees, which are used primarily to compensate the shareholder’s broker for distribution services.⁸ Part of the management fee also may be used to compensate brokers for distribution services.⁹ Operating expenses are also arguably mislabeled because they do not include portfolio transaction costs, which are the

⁷ The Commission has proposed to require most mutual funds to impose a 2% redemption fee on sales of fund shares purchased within the preceding 5 business days. See Mandatory Redemption Fees for Redeemable Fund Securities, Investment Company Act Rel. No. 26375A (Mar. 5, 2004) (proposing release).

⁸ See Mutual Fund Fact Book, supra note 1 at 52 (breaking down use of 12b-1 fees: broker compensation (63%), administrative services (32%), advertising and other promotional activities (5%)).

⁹ These payments are referred to as “revenue sharing.” See generally Laura Johannes and John Hechinger, Conflicting Interests: Why a Brokerage Giant Pushes Some Mediocre Mutual Funds, Wall Street Journal (Jan. 9, 2004) (describing revenue sharing arrangements). Regulators have recently sued brokers for failing to disclose the receipt of revenue sharing payments, see e.g., In the Matter of Morgan Stanley DW Inc., Exchange Act Rel. No. 48789 (Nov. 17, 2003), and they may be planning similar suits against mutual fund managers as well. See Tom Petrino, SEC Steps to Plate in Fund Scandal, L.A. Times (July 18, 2004) (discussing possible enforcement actions by Commission and California Attorney General regarding funds’ disclosure of revenue sharing arrangements).

costs the fund incurs in connection with trading securities in its portfolio. Portfolio transaction costs can be a fund's single largest operating expense.

Operating expenses are presented as a percentage of assets. The total of these expenses is provided on a line for the fund's "Total Annual Fund Operating Expenses." This total is known as the fund's expense ratio. Operating expenses show fees actually incurred over the previous fiscal year, assuming that any applicable fee waivers¹⁰ had not been in effect and adjusted to reflect any changes in fees.

The fee table also includes an illustrative example. The example shows the dollar amount of the fees an investor would pay if he held the shares, as well as fees paid if he redeemed the shares, at the end of 1, 3, 5 and 10 years, assuming that the investment experiences a 5% return each year and that year's expenses remain the same.

Although there has been substantial disagreement about current reform proposals, there is broad support for current disclosure requirements in the fund industry and among consumer groups. Most agree that the mutual fund fee table has promoted competition in the fund industry and enabled investors to make better decisions. There is substantial debate about whether fees have risen or declined over the last two decades, but there is general agreement that fee disclosure has caused mutual fund fees to be lower than they would be in the absence of standardized fee disclosure.

In addition, there is general recognition that the mutual fund industry is competitive, and that to some extent funds compete on fees. There are thousands of mutual funds from which to choose,¹¹ and they offer a full spectrum of fee options. Low-cost fund complexes have received a greatly disproportionate share of new cash inflows into funds, and these low-cost complexes are the largest in the industry. Vanguard, the industry's second largest manager of mutual fund assets, has built its reputation on, and

¹⁰ The fund can show operating expenses after fee waivers or reimbursements in a footnote to the fee table, provided that the expected term of the reimbursement or waiver is also disclosed.

¹¹ See Mutual Fund Fact Book 2004, supra note 1 at 36 (there were 8,126 mutual funds at the end of 2003).

uses as its strongest and primary selling point, its low-cost structure. Fund advertisements in personal finance magazines and elsewhere routinely mention or feature fees. The personal financial press virtually always mentions fees as an important factor when choosing a fund.

The evidence further suggests that the fee table, and in particular, the standardization of fees in the fee table, has played a significant role in promoting price competition in the fund industry and educating consumers about the importance of fees. Indeed, without disclosure and standardization of fees, competition and education would be severely inhibited. Personal finance writers are able to discuss fund expenses only because they have a standardized expense ratio to discuss. The mutual fund expense ratio virtually always merits its own column in tables that compare funds essential characteristics, which would not be possible without standardized expense ratio. These tables also will often highlight separately the fund's front-end and back-end loads and 12b-1 fees. Without standardized fee disclosure, academics would be limited in their ability to study fees and their effect on investment returns. In short, standardized fee disclosure provides the raw material necessary to fuel investor awareness and price competition.

Notwithstanding the importance and success of the mutual fund fee table, mutual fund fee disclosure continues to suffer from significant shortcomings. Fortunately, one silver lining of the recent mutual scandal has been to cause the Commission to consider some of these issues. The following sections discuss four major shortcomings in mutual fund fee disclosure: (1) the lack of disclosure of brokers' compensation, (2) the exclusion of portfolio transaction costs from the expense ratio, (3) the lack of disclosure of investor's actual dollar costs, and (4) the lack of comparative cost disclosure.¹² The

¹² See also Testimony of Mercer Bullard, President and Founder, Fund Democracy Inc., before the Committee on Banking, Housing and Urban Affairs, U.S. Senate (Mar. 23, 2004) (discussing, *inter alia*, needed mutual fund fee disclosure reform); Testimony of Mercer Bullard, President and Founder, Fund Democracy Inc. before the Subcommittee on Financial Management, the Budget and International Security, Committee on Governmental Affairs, U.S. Senate (Nov. 3, 2003) (same); Testimony of Mercer Bullard, President and Founder, Fund Democracy Inc., before the: Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, Financial Services Committee, U.S. House of Representatives (June 18, 2003) (same).

Commission is considering or has recently considered reforms in each of these areas. To the extent that the Commission does not follow through on current proposals, consumer groups may seek appropriate legislation in 2005.

(a) Disclosure of Brokers' Compensation

Unlike virtually all other securities transactions, transactions in mutual fund shares are not required to be accompanied by disclosure of payments received by the broker in connection with the transaction. This disclosure is normally provided for all securities transactions in a document known as the "trade confirmation" or "confirm." The confirm is typically sent to the investor within three days of the placement of the order. Confirms must be provided in connection with transactions in mutual fund shares, but for the last 25 years the Commission has permitted the mutual fund confirm to omit information about brokers' compensation.

When the Commission took this position in 1979, it was understandable why it believed disclosure of brokers' compensation was not needed on the confirm. At that time, fund distribution compensation was limited to front-end loads that were disclosed in the prospectus. The broker's compensation was evident, if not explicitly disclosed, in the confirm as the difference between the amount paid by the shareholder and the amount invested in the fund. Over the last 25 years, however, brokers' compensation arrangements have become increasingly complex and opaque, and investors are generally unaware of many of their brokers' financial incentives to sell them fund shares.

The Commission has recognized this problem and proposed to require not only that brokers' mutual fund compensation be disclosed on the confirm, but also that the compensation be disclosed at or before the time the investment decision is made in a "point-of-sale" disclosure document.¹³ Although disclosure in the confirm is an important step, its weakness is that it is received after the investor has already made his

¹³ See *supra* note 5.

investment decision and therefore is a less effective means of promoting price competition and educating investors. In contrast, the point-of-sale disclosure document will enable investors to consider information about fees before making an investment decision.

The Commission's proposal has been criticized by consumer groups as not going far enough, and by brokerage lobbyists as going too far.¹⁴ As of this writing, the proposal is still pending, although it is likely that the Commission will adopt final rules by the end of 2004.

(b) Disclosure of Portfolio Transaction Costs

As discussed above, the mutual fund expense ratio does not include costs incurred by funds in connection with the purchase and sale of portfolio securities, which are generally referred to as "portfolio transaction costs."

The information that is currently required to be disclosed about mutual fund portfolio transaction costs is not useful to investors. The only disclosure of actual portfolio transaction costs is the dollar amount of brokerage commissions paid by the fund for each of the three preceding years. This information is of limited utility because the amount that a fund spends on commissions is meaningful only in the context of the fund's size, but funds are not required to disclose their commissions as a percentage of assets. The utility of the disclosure also is limited because it is required only in the Statement of Additional Information, a document that is provided to investors only upon request and virtually never reviewed by investors or referenced in the financial press.

¹⁴ See, e.g., Letter from Mercer Bullard, Founder and President, Fund Democracy, Barbara Roper, Director of Investor Protection, Consumer Federation of America, Kenneth McEldowney, Executive Director, Consumer Action and Sally Greenberg, Senior Counsel, Consumers Union to Jonathan Katz, Secretary, Securities and Exchange Commission (Apr. 21, 2004) available at <http://www.sec.gov/rules/proposed/s70604/s70604-702.pdf>; Letter from George Kramer, Vice President and Acting General Counsel, Securities Industry Association, to Jonathan Katz, Secretary, Securities and Exchange Commission (Apr. 12, 2004) available at <http://www.sec.gov/rules/proposed/s70604/sia041204.pdf>.

Another limitation of the disclosure of commissions is that portfolio transaction costs include more than just commissions. Many securities transactions do not involve the payment of a commission, as the broker is compensated instead by acting as principal and charging a markup or markdown on the trade. These portfolio transaction costs are known as “spread costs.” Other portfolio transaction costs include “market impact costs,” which refers to the increase in price caused by selling, and decrease in price caused by buying, portfolio securities, and “opportunity costs,” which refers to the cost of delay in executing a transaction.

The only indirect disclosure of portfolio transaction costs is the fund’s turnover ratio, which appears in the financial highlights table near the back of the fund prospectus. A fund’s portfolio turnover rate measures the rate at which the fund trades securities in its portfolio. For example, a fund would have a 100% turnover rate, which is near the average for managed equity funds, if it sold its entire portfolio once during the year. While there is some disagreement about whether the turnover rate provides a reliable proxy for portfolio transaction costs, there is general acknowledgment of a positive correlation between high turnover ratios and high portfolio transaction costs.

The Commission has issued a concept release asking for comments on how to improve the disclosure of portfolio transaction costs.¹⁵ Consumer groups have argued that portfolio transaction costs should be included in the mutual fund expense ratio.¹⁶

¹⁵ See Request for Comments on Measures to Improve Disclosure of Mutual Fund Transaction Costs, Investment Company Act Rel. No. 26313 (Dec. 18, 2003) (“Concept Release”).

¹⁶ See, e.g., Letter from Mercer Bullard, Founder and President, Fund Democracy, Barbara Roper, Director of Investor Protection, Consumer Federation of America, Kenneth McEldowney, Executive Director, Consumer Action and Sally Greenberg, Senior Counsel, Consumers Union to Jonathan Katz, Secretary, Securities and Exchange Commission (Mar. 16, 2004) available at <http://www.sec.gov/rules/concept/s72903/mbullard03162004.htm>.

The fund industry opposes this position and has proposed other approaches to disclosing portfolio transaction costs.¹⁷

The various arguments are discussed in comment letters on the concept release and other documents and need not be repeated here -- except to emphasize the importance of portfolio transaction costs. As stated by the Commission, “for many funds, the amount of transaction costs incurred during a typical year is substantial. One study estimates that commissions and spreads alone cost the average equity fund as much as 75 basis points.”¹⁸ A study commissioned by the Zero Alpha Group, a nationwide network of fee-only investment advisory firms, found that commissions and spread costs for large equity funds, the expenses and turnover of which are well below average, exceeded 43% of the funds’ expense ratios.¹⁹ A survey by Lipper Inc. identified at least 86 equity funds for which the total amount paid in commissions alone exceeded the fund’s total expense ratio, in some cases by more than 500%.²⁰

Before the Commission issued its concept release, its staff indicated that it opposed including portfolio transaction costs in fund expense ratios, but it is likely that it will propose new rules requiring some form of enhanced disclosure.

¹⁷ See, e.g., Letter from Amy B.R. Lancellotta, Senior Counsel, Investment Company Institute, to Jonathan Katz, Secretary, Securities and Exchange Commission (Feb. 23, 2004) available at <http://www.sec.gov/rules/concept/s72903/ici022304.htm>.

¹⁸ See Concept Release *supra* note 15 at Part I (citing John M.R. Chalmers, Roger M. Edelen, Gregory B. Kadlec, Fund Returns and Trading Expenses: Evidence on the Value of Active Fund Management, at 10 (Aug. 30, 2001) (available at http://finance.wharton.upenn.edu/~edelen/PDFs/MF_tradexpenses.pdf). “These estimates *omit the effect of market impact and opportunity costs*, the magnitude of which may exceed commissions and spreads.” *Id.* (emphasis added).

¹⁹ See Jason Karceski, Miles Livingston & Edward O’Neal, Mutual Fund Brokerage Commissions at 9 (Jan. 2004) (available at http://www.zeroalphagroup.com/headlines/ZAG_mutual_fund_true_cost_study.pdf).

²⁰ See Sara Hansard, Lipper Data Miffs Some Firms, Investment News at 3 (Feb. 23, 2004) (173 funds paid commissions in excess of 0.99% of net assets, which is the dollar-weighted average expense ratio for equity funds).

(c) Disclosure of Dollar Amount of Expenses

Mutual funds are not required to disclose the actual dollar amount of expenses incurred by individual investors. The Government Accountability Office (formerly the General Accounting Office) advocated for such disclosure, specifically, that the Commission require disclosure of the dollar amount of each individual shareholder's expenses on his quarterly statements.²¹ The Commission formally considered the GAO's proposal, but rejected it in favor of requiring disclosure in the shareholder report of the dollar amount of expenses incurred on a hypothetical \$1,000 account.²²

Consumer groups had opposed the Commission's approach, principally because the shareholders who would most benefit from fee disclosure generally do not read the shareholder report.²³ The purpose of disclosure of dollar amounts is to draw shareholders' attention to the actual costs, and in particular price insensitive shareholders who need fee information to be brought to their attention. For these shareholders, the quarterly statement would provide the most effective communication vehicle. The fund industry primarily argued that disclosure of actual costs in quarterly statements would be too expensive,²⁴ an argument that was substantially undermined when the Massachusetts

²¹ See Government Accounting Office, Mutual Funds: Information On Trends In Fees And Their Related Disclosure (March 12, 2003).

²² See Shareholder Reports and Quarterly Portfolio Disclosure of Registered Management Investment Companies, Investment Company Act Rel. No. 26373 (Feb. 27, 2004) (adopting release) (requiring disclosure of dollar amount of expenses in shareholder reports for periods after ending on or after July 9, 2004).

²³ See, e.g., Letter from Mercer Bullard, Founder and President, Fund Democracy, Barbara Roper, Director of Investor Protection, Consumer Federation of America, to Jonathan Katz, Secretary, Securities and Exchange Commission (Feb. 14, 2004) available at <http://www.sec.gov/rules/proposed/s75102/mbullard1.htm>; see also It Pays to Watch Those 401(k) Fees, 7 Hewitt Magazine Online (quoting November 2003 Congressional testimony of Don Phillips, Managing Director, Morningstar, Inc.: "We have truth-in-lending laws that detail to the penny the dollar amount homeowners will pay in interest on their mortgage; isn't it time for a truth-in-investing law that would bring the same commonsense solution to mutual funds?") available at http://was4.hewitt.com/hewitt/resource/rptspubs/hewitt_magazine/vol7_iss1/upfront-hewitt-04.html.

²⁴ See, e.g., Testimony of Paul Haaga, Jr., Chairman, Investment Company Institute, before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, Committee on Financial Services, U.S. House of Representatives (June 18, 2003) available at <http://financialservices.house.gov/media/pdf/061803ph.pdf>.

Financial Services (MFS) fund complex announced that it intended to provide essentially the same disclosure to its investors that was advocated by consumer groups.

(d) Comparative Disclosure of Fees

It may be that no form of fee disclosure would be more effective at educating investors and promoting competition than comparative fee disclosure. Comparative fee disclosure – be it comparisons to average fees for a particular type of product or actual fees charged by specific, comparable products – provides the most direct, understandable way to communicate the idea that fees are variable and can be raised or lowered through investor choice. No amount of clarity can place the amount of a fee in context unless it is shown with fees charged for other products.

Although the Commission is considering some forms of comparative fee disclosure for the point-of-sale document and confirm, it generally has rejected this form of disclosure in the context of fees. This stands in contrast to its position on investment performance, where it has required that funds display their investment performance alongside the investment performance of an appropriate benchmark index. The Commission explained that the “purpose of this [benchmark index] requirement is to provide investors with an objective standard against which they can compare the performance of the fund.”²⁵ The need for an objective standard against which to compare fees is no less important.

²⁵ Disclosure and Analysis of Mutual Fund Performance Information: Portfolio Manager Disclosure, Investment Company Act Rel. No. 17294 (Jan. 8, 1990) (proposing release).

III. 401(k) Plan Fee Disclosure

(a) General Policy Considerations

The principles that apply to government-mandated fee disclosure in the mutual fund context apply equally in the 401(k) plan context. The Department of Labor (“DOL”) can educate investors and promote competition by requiring standardized, transparent disclosure of 401(k) plan fees. The effect of fee disclosure will be to reduce costs and enable investors to make more informed investment decisions.

Some have suggested that these principles might not apply in the 401(k) plan context, citing two primary arguments. The first argument is that 401(k) plans generally offer a fixed set of investment options, and the only important factor for participants to consider is how each option fits with the participant’s particular investment objectives and risk profile.²⁶ It is the plan sponsor’s responsibility to evaluate fees when selecting investment options for and designing the plan. Participants should accept fees as a fait accompli.

In fact, fees are no less important to participants in 401(k) plans than in other contexts. Fees are obviously relevant for plans that offer a large number of investment options.²⁷ Such plans resemble the same marketplace in which investors evaluate mutual funds, and the benefits realized from standardized mutual fund fee disclosure apply equally. To the extent that 401(k) plan participants have many investment options from which to choose, they can make superior decisions to the extent that the fees charged by these investment options are fully disclosed and disclosed in a way that facilitates

²⁶ See Study of 401(k) Plan Fees and Expenses, Pension and Welfare Benefits Administration, Department of Labor at § 3.7 (paraphrasing testimony of M. Barry); Tom Woodruff, Check Out Your 401(k) Fees, Capitol Connection (1997) (quoting Lynn Dudley, Association of Private Pension and Welfare Plans: “Participants care about net returns, not the service-by-service breakdown of plan expenses.”) available at <http://www.moneycentral.msn.com/articles/tax/capitol/1581.asp>.

²⁷ For example, in 1997 3.7% of plans offered access to a “mutual fund window” that provided access to one or several families of funds. See Study, *id.* at § 2.4.1.2.

comparison with other options. Fee disclosure will promote competition and drive down fees. Of course, studies have suggested that offering a large number of investment options may deter 401(k) plan participation, so this structure may not be one that the DOL should encourage, but even where there are only two options with similar investment objectives and risk characteristics, participants will benefit from standardized, transparent fee disclosure.

Indeed, participants will benefit even when the plan offers only one investment option for each type of investment. Standardized fee disclosure provides participants with the information they need not only to compare investment options within a 401(k) plan, but also to compare their 401(k) plan with other investment options and evaluate it as a form of employee compensation. Full disclosure of plan fees would enable participants, for example, to compare 401(k) plans offered by other employers²⁸ and pressure their employers to address excessive fees.²⁹ In this respect, comparative fee disclosure – that is, disclosure of fees charged by investment options in other plans as well as fees charged by the plan itself – would serve as a useful indicator of the relative merits of a particular 401(k) plan.

The DOL should not view 401(k) plans as a closed market. They compete with a wide array of investment vehicles, and plan participants therefore need fee disclosure to evaluate their 401(k) plans. Granted, not long ago there were few non-401(k) tax-deferred investment vehicles and the tax benefits of 401(k) plans were uniquely advantageous. But this time has passed. Today, investors have many options for tax-deferred investing, including IRAs, Roth IRAs, 529 plans, Coverdell Education Savings

²⁸ The difference between the most and least expensive 401(k) plans can be as high as 300%. See Al Otto, Peeling the Onion on 401(k) Expenses, BenefitNews.com (Sep. 1, 2002) (citing The 401(k) Averages Book, 6th Ed.) available at <http://www.benefitnews.com/retire/detail.cfm?id=3403>; see also Ric Edelman, Are You Paying Too Much For Your 401(k)? Inside Personal Finance (Apr. 4, 2003) (citing study showing annual fees for a 300-person plan ranging from \$158 to \$767) available at <http://www.ricedelman.com/planning/retirement/payingmuch.asp>.

²⁹ For example, “if participants knew how much optional features of their plans cost, would they demand so many?” Study, supra note 26 at § 3.7 (citing Statement by S. O’Brien, AFL-CIO, before the Pension and Welfare Benefits Administration, Department of Labor (Nov. 12, 1997)).

Accounts, Health Savings Accounts, variable annuities and other products, and current trends suggest the number of tax-deferred investment vehicles will continue to expand. Further, the reduction in capital gains rates has also reduced the tax advantages of 401(k) plans, the distributions from which are subject to higher income tax rates. While 401(k) plans do offer unique advantages such as matching employer contributions, matching contributions typically fall far short of 401(k) contribution limits, thereby invariably leaving participants needing the ability to compare their 401(k) plans – including their costs – with other investment vehicles.

A second argument often made for limiting 401(k) plan fee disclosure is that fee disclosure for different types of investment options already is regulated by other governmental entities. Why should the DOL second-guess the judgments of insurance, banking and securities regulators with respect to the appropriate level of fee disclosure for the products that they regulate?

The answer is both political and practical. As a political matter, it is the DOL, not any other regulator, that is responsible for determining what kind of fee disclosure should be provided to 401(k) plan participants, and that determination must be made within the context of the unique policy interests underlying the creation of 401(k) plans. These plans were created by statute to achieve a specific government purpose – to help Americans provide for their retirement security³⁰ – and the government indirectly finances that purpose in the form of foregone or deferred tax revenues. To the extent that uninformed decisions about investments result in beneficiaries paying higher fees and/or receiving fewer or inferior services, a specific government policy will have been subverted, in addition to the general reduction in American's wealth and freedom of choice. These concerns are not as strongly implicated for bank, securities and insurance products sold outside of the 401(k) plan context.

³⁰ In actuality, this is belied by the reported origin of 401(k) plans, whose creation may owe more to the creativity of the employee benefits bar than to any directed governmental policy. Nonetheless, a fairly clear and widely accepted governmental purpose has been retrofitted to 401(k) plans and other tax-deferred, investment vehicles created over the last 20 years.

As a practical matter, 401(k) plan participants represent a special class of investors who have unique needs for which fee disclosure rules for other investment vehicles are not designed. Insurance, banking and securities regulators have crafted rules for sales to retail customers that typically occur in the context of some form of advisory relationship with a broker, insurance agent and/or trust department employee. In each context, regulators rely on the regulation of salespersons, such as the requirement that investments be suitable, to work together with disclosure rules to ensure that retail investors are provided with the information they need. While these sales regulations may apply to the relationship between the plan provider and the plan sponsor, they generally do not apply with respect to participants, who receive their information from their employer.

Plan sponsors do not have fiduciary obligations regarding participants' plan investments; rather, Section 404(c) expressly exempts sponsors from fiduciary liability. In this situation, it is important to impose stronger disclosure requirements to compensate for the absence of a regulated relationship with a salesperson, but the DOL has not appropriately adjusted disclosure rules applicable to 401(k) plan investment options. To illustrate, the securities laws impose different disclosure rules when a mutual fund is sold directly, rather than through a broker. In the direct-sale context, a standardized disclosure document – a prospectus – must be provided to the investor *before* the investment decision is made.³¹ Section 404(c) regulations require only that a prospectus be provided *after* the investment decision is made, and that applies only for products subject to the Securities Act of 1933. For other investments, no affirmative disclosure is required at all.

Thus, the DOL has a political and practical responsibility to ensure that 401(k) plan participants receive information about plan fees. As a general matter, such disclosure will enable participants to make informed decisions and reduce costs by promoting competition. This step not only will further the goal of efficient, wealth-producing regulation of 401(k) plans, but also will further the particular policy goal

³¹ The Commission has recently proposed to require disclosure of fee information before the investor makes an investment decision even when the purchase is made through a broker. See supra note 5.

underlying 401(k) plans of helping Americans ensure their retirement security. As discussed immediately below, substantial reforms are needed to achieve these goals.

(b) Current 401(k) Fee Disclosure Requirements

Currently, 401(k) plan fee disclosure is regulated by a carrot and stick approach. Section 404(c) and regulations thereunder – the carrot – limit plan fiduciaries’ responsibility for participants’ investments if participants are provided with certain information about plan investment options. This information includes:

(v) A description of any transaction fees and expenses which affect the participant's or beneficiary's account balance in connection with purchases or sales of interests in investment alternatives (e.g., commissions, sales load, deferred sales charges, redemption or exchange fees);

. . . and . . .

(viii) In the case of an investment alternative which is subject to the Securities Act of 1933, and in which the participant or beneficiary has no assets invested, immediately following the participant's or beneficiary's initial investment, a copy of the most recent prospectus provided to the plan.

Other information about fees must be made available upon request, but not affirmatively provided, to participants. Fiduciaries of plans that fall outside of the Section 404(c) safe harbor live under the “stick” of heightened liability risk and are generally left to disclose plan fees as they deem appropriate.

This regulatory approach is fundamentally inadequate.³² First, whether a plan fiduciary opts to rely on the Section 404(c) safe harbor is merely tangential to the question of whether and to what extent fee information should be provided to plan

³² See Anne Tergesen, Does Your 401(k) Cost Too Much? Business Week (June 7, 2004) (figuring out what plan participants are paying in fees can be “tricky, because of a system of disclosure that puts the burden on you to request documents and comb through the fine print”).

participants.³³ The availability of the safe harbor turns on whether plan participants exercise control over their 401(k) plan assets, but fee disclosure would provide participants with useful information to the extent that they have *any choice* with respect to plan investment options or their participation in the plan.³⁴ Rules regarding 401(k) plan fee disclosure should be functional, reflecting the level of fee disclosure that is appropriate in view of its actual usefulness to participants, and not whether the employer, either inadvertently or by design, falls under the protection of the Section 404(c) safe harbor.³⁵

Second, current fee disclosure requirements are insufficient to provide participants with the information they need to make informed investment decisions and reduce costs by promoting competition. Section 404(c) regulations require only that information about certain transaction-related fees and a 1933 Act prospectus (as applicable) be provided to participants. The prospectus need not be provided until after the investment decision has been made, whereas, as noted above, the federal securities laws require that direct mutual fund sales be preceded by prospectus delivery. It is illogical that a self-directed investor who buys a mutual fund is entitled to pre-sale delivery of the prospectus, while a 401(k) participant, who is likely to be less sophisticated and in greater need of assistance, is entitled only to post-sale delivery of the prospectus. The current Section 404(c) standard has the effect of stripping less sophisticated investors of the rights they would have if they had purchased the fund directly. The gap between investors inside and outside of 401(k) plans is likely to widen, as the Commission has proposed to require that all investors be provided with pre-sale

³³ See, e.g., Planning for Retirement, ERISA Advisory Council (Nov. 14, 2001) (citing comments by Joe Canary, Chief, Chief in the EBSA Office of Regulations and Interpretations: “[ERISA] was not designed to ensure, for example, that employees were educated, advised or assisted in planning for retirement.”).

³⁴ One could argue that, even where plan participants exercise no discretion, they are entitled to a minimum amount of information about a 401(k) plan, even if only to enable the participant to better understand and evaluate all aspects of his employment compensation.

³⁵ Similarly, if the DOL believes that delivery of a mutual fund prospectus is necessary to adequately apprise participants of information about investment options, then it should not permit other products sold by brokers, banks and insurance companies to provide inferior disclosure.

information in connection with mutual fund purchases, whether direct-sold or broker-sold.

Even more illogical is the absence of any fee disclosure requirements, other than for certain transaction fees, for non-1933 Act investment options. These investment options are normally sold by brokers and trust department employees who are subject to independent fiduciary or suitability obligations, not to mention their natural incentive to provide good service to retain their clients. It is imperative that 401(k) plan participants, who must rely on an employer whose fiduciary responsibilities nullified by Section 404(c), receive more information, not less, than typically provided outside of the 401(k) plan context.

Finally, the requirement that additional fee information be made available upon request is inadequate. Participants who take the initiative to request information about fees are least likely to need government-mandated fee disclosure. Fee disclosure is most effective for those who are generally price insensitive and who will benefit from having the importance of fees specifically brought to their attention. As articulated by Justice Brandeis: “To be effective, knowledge of the facts must be actually *brought home to the investor*.”³⁶ Legally mandated disclosure requirements generally presume the absence of sufficient market mechanisms to apprise buyers and sellers of important information. Fee disclosure is generally necessary precisely because many investors will not otherwise attend to this information. The DOL should require affirmative disclosure of fees to ensure that investors consider fees when evaluating their 401(k) plans.

³⁶ Quoted in Testimony of Matthew P. Fink, President, Investment Company Institute before the Pension, Welfare Benefits Administration, Department of Labor (Nov. 12, 1997) (emphasis added).

(c) Recommended Form and Content of 401(k) Plan Fee Disclosure

Participants in 401(k) deserve standardized fee disclosure to help them make informed investment decisions and promote competition among 401(k) plan investment options and providers. Participants in 401(k) plans also have special needs, as they are less likely to be as self-directed or informed as investors who invest on their own initiative outside of 401(k) plans or with the assistance of an investment professional. Further, the government's special policy interest in employees' saving for retirement through 401(k) plans militates for providing as successful and transparent an investment product as possible.³⁷

The 401(k) plan disclosure document should be specifically tailored for 401(k) plan participants. It should focus on the relationship between the investment and an employee's retirement, with charts illustrating the risk/return characteristics of each option for different participants based on their years to retirement.³⁸ The disclosure document should be integrated with the periodic account statements received by participants so that the most important information can be reinforced on a regular basis and in the document that participants are most likely to review. The disclosure should present the information in context by comparing aspects of the plan with other types of investments, especially tax-deferred investments. The disclosure should be provided, as practicable, before the participant makes an investment decision, and periodically

³⁷ In addition to the following recommendations regarding 401(k) plan fee disclosure, the DOL should consider requiring plan sponsors to offer a low-cost investment option as one condition of satisfying the obligation to provide a "broad range of investment alternatives" under the Section 404(c) safe harbor. See generally Testimony of Mercer Bullard, President and Founder, Fund Democracy, Inc. before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, Committee on Financial Services, U.S. House of Representatives (June 2, 2004) (recommending that Congress consider requiring 529 plan sponsors to provide a low-cost investment option); see also Letter from Michael G. Oxley, Chairman, Financial Services Committee, U.S. House of Representatives to William H. Donaldson, Chairman, U.S. Securities and Exchange Commission (July 15, 2004) (recommending that 529 plans offer at least one low-cost investment option).

³⁸ Accord, Planning for Retirement, supra note 33 (recommending that the DOL "explore regulatory measures designed to encourage employers to provide retirement planning advice to their employees. This might include, for example, the creation of templates that could be used to provide information for employees on important retirement planning issues.").

provided as long as the participant is in the plan (especially if there are material changes in the plan or any investment option in which the participant is an investor).

The structure of disclosure for 401(k) plans should be layered.³⁹ At the top layer, employers should be required to provide each participant with a brief, standardized disclosure document. This document should provide information about the 10 or 12 most important factors that a plan participant should consider when evaluating a plan. This document should be designed to accommodate all of the principal types of investment options offered under 401(k) plans, and it should not be longer than a four-page brochure-style document. The mutual fund profile would provide a good model for such a document, although it would have to be redesigned to incorporate plan expenses and accommodate non-mutual fund investment vehicles.⁴⁰ Additional layers of more detailed information can be required to be provided upon request.

The information on fees in the disclosure document should include all fees paid in connection with the participant's investment. Fee disclosure should be standardized, both in terms of the way the fees are calculated and the way they are presented. The disclosure document should show fees charged for comparable investments and comparable plans. If the plan offers more than one investment option of the same type (e.g., more than one large capitalization equity fund), then the fees for each should be presented side-by-side. Fees in the disclosure document should be presented as a percentage of assets for ease of comparison. The disclosure document should provide an example of the dollar amount of fees similar to that provided in mutual fund prospectuses, and the participant's periodic account statement should show the dollar

³⁹ For discussions of a layering approach to disclosure, see Shareholder Reports, supra note 22 & Letter from Mercer Bullard, supra note 23.

⁴⁰ The mutual fund profile is a short-form prospectus that the Commission has permitted to replace the prospectus for purposes of fulfilling pre-sale disclosure obligations. See generally Investment Company Rel. Nos. 22529 (Feb. 27, 1997) (proposing release) & 23065 (Mar. 13, 1998) (adopting release). The DOL has taken the position that the profile may be used in lieu of the prospectus to satisfy Section 404(c) regulatory requirements. See DOL Advisory Opinion 2003-11A (Sep. 8, 2003).

amount paid by the participant for that period. Operating expenses for investment options should be required to include portfolio transaction costs.

Fee disclosure should provide separate disclosure of any fees received by persons who play any role in assisting the participant to decide whether to invest in the 401(k) plan and which investment options to choose. As the Commission has recognized with its point-of-sale/confirmation proposal, see supra note 5, it is important for investors to know not only how much they are paying in fees, but also how much their advisers are receiving for favoring certain investment options over others. Incentive payments to those who advise plan sponsors and/or participants may cause them to put their interests ahead of their clients' interests.⁴¹ These incentives should be fully and prominently disclosed to plan participants.

A similar conflict of interest can exist when an employer shifts plan expenses from itself to employees.⁴² The conflict may be created when sponsors negotiate lower plan expenses in exchange for selecting high cost investment options, thereby shifting costs from sponsors to participants.⁴³ This conflict is more complex than when a salesperson is compensated for recommending a particular product. Evidence of any linkage between the sponsor's selection of the investment option and the reduction in its own expenses is likely to be only circumstantial, and in any case, the sponsor could

⁴¹ The Commission is reportedly investigating side payments by plan providers to consultants for plan sponsors. See Kathleen Pender, SEC Shines Light on 401(k) Fees, San Francisco Chronicle (July 8, 2004); Tergesen, supra note 32.

⁴² See generally Colleen Medill, Stock Market Volatility and 401(k) Plans, 34 U. Mich. L. Reform 469, 502-03 (Spring 2001) ("Less noticed, but potentially much more significant from the perspective of national retirement policy, is the subtle abuse of 401(k) plan assets that every employer, large or small, can engage in when selecting investment options for its 401(k) plan. This abuse occurs when the employer attempts to reduce its cost of 401(k) plan sponsorship by allowing the service provider to charge higher fees and expenses to the participants in the 401(k) plan as a quid pro quo for lower administrative fees charged to the employer.").

⁴³ See generally Study supra at note 26 at §3.33 ("many providers charge a lesser amount [in plan set-up fees] and recoup the difference from investment management fees") & Tables III-2, III-3 & III-4 (Apr. 13, 1988) (showing trend toward plan participants paying increasing share of plan administrative costs); Edelman, supra note 28 (providers "may charge low or no administrative fees, but recoup the difference by charging exorbitant asset management fees.")

accomplish the same result by simply choosing lower cost options and declining to pay the plan expenses. The issue may be as much one of misrepresentation of the employee benefits provided as one of an improperly motivated “recommendation” by the employer.⁴⁴ It is not immediately clear whether disclosure rules could adequately address this issue, except indirectly by requiring clear disclosure of all plan expenses and identifying those expenses paid by the sponsor.⁴⁵

Some might argue that the foregoing disclosure requirements would impose greater burdens on employers, thereby making them less likely to offer 401(k) plans.⁴⁶ In fact, quite the opposite will be true. The adoption of a short, standardized disclosure document would reduce printing and compliance costs and remove the uncertainty that exists with respect to requirements regarding transaction fees, non-1933 Act investments, and the information that sponsors are required to make available to participants to qualify for the Section 404(c) safe harbor.⁴⁷ At least one commentator has suggested that the kinds of disclosure described above may be required of plan fiduciaries even if they have

⁴⁴ See generally Medill, *supra* note 42 at 502-03 (suggesting that employee might have a cause of action if an employer selected a plan with higher fund expenses on the ground that the administrative expenses paid by the employer would be lower).

⁴⁵ In any case, a plan sponsor has a fiduciary duty to consider information about plan fees. See Understanding Retirement Fees and Expenses, Employee Benefits Security Administration, Department of Labor at 2 (May 2004).

⁴⁶ See, e.g., Increasing Pension Coverage, Participation and Benefits, ERISA Advisory Council, Department of Labor (Nov. 12, 2001) (“perception that pension plan sponsorship involves ‘too many government regulations’ is a common concern among employers of all sizes. With respect to smaller employers, this was a reason given by 47% of those employers in the 2001 SERS for not sponsoring a pension plan for their employees. For 22% this was a major reason, and for 4% this was the most important reason.”).

⁴⁷ Current 404(c) regulations require that employers make available upon request:

- (i) A description of the annual operating expenses of each designated investment alternative (e.g., investment management fees, administrative fees, transaction costs) which reduce the rate of return to participants and beneficiaries, and the aggregate amount of such expenses expressed as a percentage of average net assets of the designated investment alternative;

This requirement provides little guidance as to what form such disclosure should take for different types of investments.

complied with the Section 404(c) safe harbor.⁴⁸ Some sponsors may wish to provide more information than that required under Section 404(c), but fear litigation if they do.⁴⁹

IV. Conclusion

Millions of Americans rely on their 401(k) plans to provide for their retirement, yet current rules do not require that plan sponsors provide them with adequate information about fees and other information. Participants in 401(k) plans are actually entitled to less protection and disclosure than investors outside of 401(k) plans, despite the fact that 401(k) plan participants are likely to be less sophisticated and receive less regulated guidance from investment professionals regarding their investment decisions. The DOL should ensure that 401(k) plan participants are fully informed about the costs of their 401(k) plans by requiring plan sponsors to deliver a standardized disclosure document to all participants.

⁴⁸ See Yolanda Sayles, ERISA Section 404(c) Plan Fees and Expenses: Is There An Affirmative Fiduciary Duty to Disclose? 25 Wm. Mitchell L. Rev. 1461, 1493-1498 (1999); see generally Martha Priddy Patterson, Disclosure in 401(k) Plans: It's Cheaper to Communicate than Litigate, reprinted from The 401(k) Handbook (July 2000) available at <http://www.benefitslink.com/articles/priddy000628.html> (suggesting that legal obligations to disclose may exceed ERISA mandates).

⁴⁹ See, e.g., Planning for Retirement, supra note 33 (citing comments of Lou Campagna, EBSA Office of Regulations and Interpretations, that the DOL “has not provided guidelines for employers who seek to provide information about investment management and retirement planning and that some plan have been reluctant to provide more than the minimum information required under the statute in order to avoid possible litigation.”).

Exhibit A – Sample Mutual Fund Fee Table

Fees and Expenses

This table describes the fees and expenses that you may pay if you buy and hold shares of the Fund.

SHAREHOLDER FEES	<i>(fees paid directly from your investment)</i>		
	Class A	Class B	Class C
Maximum sales charge (load) as a percentage of offering price	5.75%	4.00%	1.00%
Load imposed on purchases	5.75%	None	None
Maximum deferred sales charge (load)	None ¹	4.00% ²	1.00%
Redemption fee on shares held less than 30 days ³	2.00%	2.00%	2.00%

Please see “Choosing a Share Class” on page 19 for an explanation of how and when these sales charges apply.

ANNUAL FUND OPERATING EXPENSES	<i>(expenses deducted from Fund assets)⁷</i>		
	Class A	Class B	Class C
Management fees ¹	1.25%	1.25%	1.25%
Distribution and service (12b-1) fees	0.35%	1.00%	1.00%
Other expenses (including administration fees) ⁴	0.62%	0.62%	0.62%
Total annual Fund operating expenses ^{4,5}	2.22%	2.87%	2.87%

1. There is a 1% contingent deferred sales charge that applies to investments of \$1 million or more (see page 20) and purchases by certain retirement plans without an initial sales charge.

2. Declines to zero after six years.

3. The redemption fee is calculated as a percentage of the amount redeemed (using standard rounding criteria), and may be charged when you sell or exchange your shares or if your shares are involuntarily redeemed. The fee is retained by the Fund and generally withheld from redemption proceeds. For more details, see “Redemption Fee” section.

4. The Fund began offering Class A, B and C shares on August 11, 2003. The management fees and distribution and service (12b-1) fees shown are based on the Fund’s maximum contractual amounts. Other expenses are restated and do not include extraordinary expenses, such as the costs associated with the conversion of the Fund from a closed-end fund to an open-end fund and certain litigation prior to the conversion. If such expenses were included, other expenses would have been 1.38%.

5. For the fiscal year ended August 31, 2003, the manager and administrator had agreed in advance to limit their respective fees and to assume as their own expense the legal fees and expenses incurred by the Closed-End Fund and its directors with respect to the litigation and settlement with Harvard Management Company, Inc. and the manager also paid the legal fees and expenses incurred by the Closed-End Fund through March 20, 2003, with respect to the Closed-End Fund’s proxy contest relating to its annual shareholders’ meeting. With these limitations, management fees were 0.97% and total annual Fund operating expenses, absent the extraordinary expenses disclosed in footnote 4, would have been 1.69% for Class A, 2.34% for Class B and 2.34% for Class C.

Example

This example can help you compare the cost of investing in the Fund with the cost of investing in other mutual funds. It assumes:

- You invest \$10,000 for the periods shown;
- Your investment has a 5% return each year; and
- The Fund’s operating expenses remain the same.

Although your actual costs may be higher or lower, based on these assumptions your costs would be:

	1 Year	3 Years	5 Years	10 Years
If you sell your shares at the end of the period:				
Class A	\$787 ¹	\$1,229	\$1,696	\$2,982
Class B	\$690	\$1,189	\$1,713	\$3,041 ²
Class C ³	\$390	\$889	\$1,513	\$3,195
If you do not sell your shares:				
Class B	\$290	\$889	\$1,513	\$3,041 ²
Class C ³	\$290	\$889	\$1,513	\$3,195

1. Assumes a contingent deferred sales charge (CDSC) will not apply.

2. Assumes conversion of Class B shares to Class A shares after eight years, lowering your annual expenses from that time on.

3. Revised to show the elimination of the initial sales charge on January 1, 2004. Based on the restated total annual fund operating expenses shown on page 11, but without the elimination of the initial sales charge, the costs would have been \$486, \$980, \$1,598 and \$3,263, respectively, if you sell your shares at the end of the period or \$387, \$980, \$1,598 and \$3,263, respectively, if you do not sell your shares.