Remarks of Mercer Bullard

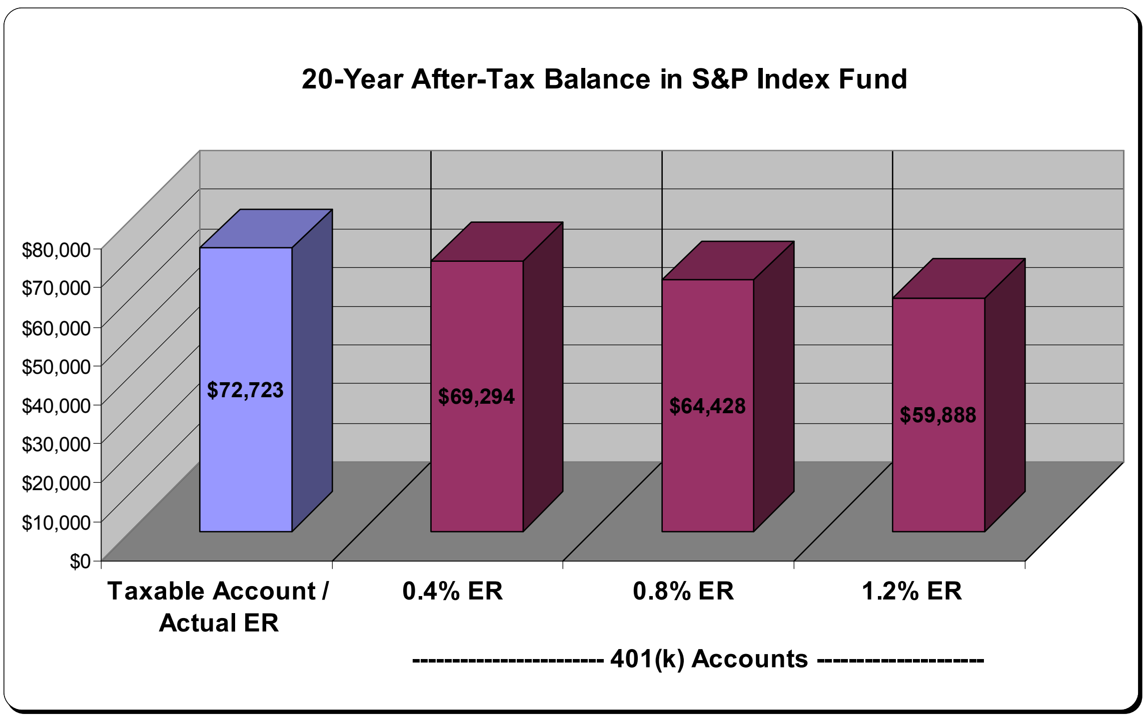
Hearing on 401(k) Fee Disclosure

Before the Senate Special Committee on Aging

Oct. 24, 2007

Good morning Chairman Kohl, Ranking Member Smith, members of the Committee. Thank you for the opportunity to discuss 401(k) fees with you this morning.

We are here today b/c 401k fees are crucially important to the retirement security of over 40 million Americans. At the risk of restating an oft-repeated set of data, I'd like to direct your attention to the chart on my right [below].



Raw Data source: Morningstar Analysis by Craig Israelsen, Ph.D., Brigham Young University

The three purple bars[1] show the after-tax account balance of a $10,000 initial investment in a 401k plan's S&P 500 index fund option under three different total expense ratios assumptions: .4, .8 and 1.2 percent. I'd like to thank Craig Israelsen, an economics professor with Brigham Young University, for putting this chart together for this hearing.

The plan with a .4% expense ratio has a balance of about $69,000 after taxes, the .8% expense ratio produces a balance of about $64,000, and the 1.2% expense ratio

[1] For readers of the black and white version, these are the three bars on the right.

produces about a $60,000 balance. Obviously, what appears to be a small difference in fees produces a significant difference in value.

The blue bar on the far left[2] shows the after-tax balance of a taxable account invested in the Vanguard S&P 500 index fund from 1987 to 2006. This is a real fund, its expense ratio during the period ranged from 0.26% to 0.18%. The balance is about $3,500 greater than the .4% fee 401k plan, and about $13,000, or about 21%, higher than for the 1.2% fee 401k plan. Thus, not only do fees matter within a 401k plan, but high 401k fees can actually undo the tax benefits of the 401k plan altogether and leave employees better off investing elsewhere.

This chart reminds us that fees matter, but it actually does more than that. I'd like to use it to make three points about fee disclosure.

First, note that the bar chart translates expense ratios into hard dollars. Why is it that when the GAO, the SEC, Congressional witnesses -- and Chairman Kohl this morning -- discuss the impact of fees they don't simply say fees are important because 1.2% is greater than .8%, which is twice as much as .4%? Why do they always use dollars when they are describing the impact of fees?

The answer is that we understand dollar amounts better than percentages. We appreciate the fact that a $10,000 difference in our balance when we begin retirement will have a significant impact on our standard of living. Yes, fees do matter, and if they matter enough to highlight for plan beneficiaries, then shouldn't they be disclosed in the same way that virtually all commentators use to illustrate the importance of fees?

Perhaps fee savvy investors understand that a .4 percentage point difference in fees will have a substantial impact on their account balances in retirement. That is what it means to be fee savvy. And if everyone were fee savvy, we wouldn't be here today. We are here today b/c the committee recognizes that many 401k beneficiaries are not fee sensitive. We regulate fee disclosure precisely to communicate with investors who are not fee sensitive, not with those investors who are fee savvy.

So my first point is that 401k fee disclosure should provide investors with a close estimate of the dollar amount of fees they actually paid.

My second point is that fee **comparisons** are crucial to effective fee disclosure. The reason this chart is effective is not just its disclosure in dollar amounts. It is also effective because it shows you the results you would have achieved in a different investment. Information has no meaning without context, and investors who are not sensitive to fees in the first place are unlikely to have the context in which to understand stand-alone expense ratios or stand-alone dollar amount charges.

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[2] For readers of a black and white version, it is the bar at the far left.

The third point that this chart illustrates is that it is effective because most of the people in this room have actually looked at it. I had this chart created precisely to get my audience's attention. The chart is fairly effective because in a context where I own 5 minutes of your time I can make it something you think about.

The same principle applies with respect to fees. Fee disclosure is most effective when the delivery vehicle is one that investors are likely to use. Mr. Campbell has discussed the excellent educational materials on fees that his office has made available to the public. But the investor who seeks out those materials is not the investor who is least sensitive to fees. The short form summary of each investment option in a plan is a crucial document for beneficiaries. But it is unlikely that beneficiaries who are insensitive to fees will use it.

Investors who are insensitive to fees are likely, however, to review their quarterly statements. Most people like to see how much money they have invested, the value of their accounts, how much they earned in good times, and even how much they lost in bad times. The quarterly statement is like the chart over there because it is a delivery vehicle that works.

When I see an unexplained $10 charge on my bank account statement, I find out what it was for. Imagine the effect when the investor in the 401k index fund option with the 1.2% expense ratio sees that he paid $225 in fees last quarter, and that he would paid only $37 in fees if he had been invested in an index fund that charged only .2%. $225 v. $37. I hope that you will agree that that is effective fee disclosure.

Thank you again for the opportunity to appear before the committee today. I hope that I can help you with any questions you may have.