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HIGH-COST SMALL COMPANY 401(K) PLANS CAN COST RETIREMENT SAVERS HUNDREDS OF THOUSANDS OF DOLLARS OVER THEIR CAREERS

Retirement savers will need to work several years longer to make up the difference or make do with less in old age

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Summary

Many workers save for retirement primarily through a tax-advantaged workplace retirement plan, such as a 401(k). But not all 401(k)s are created equal. Generally, large companies (those that employ a large number of workers and have a large amount of investment assets in their plans) have lower cost retirement plans than small companies (those that employ a small number of workers and have a small amount of investment assets in their plans). But even between similarly sized small company plans, the costs of these plans can vary considerably and the investing outcomes for retirement savers that result from these differences can be staggering over time.

Comprehensive data regarding small company retirement plans is not publicly available due to gaps in regulatory reporting requirements. However, information that is publicly available, as well as supplementary privately available information, suggests that high costs in many small company retirement plans could reduce retirement savers' nest eggs by hundreds of thousands of dollars over their careers, requiring savers to work several years longer to make up the difference or make do with less in old age.[1]

Using publicly available data published by ICI/Brightscope,[2] we found that:

- A hypothetical worker who participates in an **average-cost plan with less than $1 million in assets for 40 years** could retire with approximately **$292,000 less** than if this worker participated in an **average-cost plan with more than $1 billion in assets**. To make up this difference, a worker earning the average national wage of $63,795[3] would need to work for a little more than **4.5 years longer**.
- A hypothetical worker who participates in an **average-cost plan with between $1 million and $10 million in assets for 40 years** could retire with approximately **$226,000 less** than if this worker participated in an **average-cost plan with more than $1 billion in assets**. To make up this difference, a worker earning the average national wage would need to work **3.5 years longer**.
- A hypothetical worker who participates in a **high-cost plan with less than $1 million in assets for 40 years** could retire with approximately **$559,000 less** than if this worker participated in a **similarly-sized low-cost plan**. To make up this difference, a worker earning the average national wage would need to work for a little more than **8.7 years longer**.

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[1] All hypothetical illustrations consider a retirement saver who participates in a plan for 10, 20, 30, and 40 years, contributes $500 per month over those terms, and receives an average 7% real annual rate of return. All calculations are made using Pew Trusts, How Fees Affect Retirement Savings Over Time, An interactive illustration, DATA VISUALIZATION, October 23, 2018, https://www.pewtrusts.org/en/research-and-analysis/data-visualizations/2018/how-fees-affect-retirement-savings-over-time?track=your-investment&slide=your-investment-plan

[2] The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2020, September 2023, https://www.ici.org/system/files/2023-09/23-rpt-dcplan-profile-401k.pdf

[3] According to the Social Security national average wage index, based on 2022 data. Social Security National Average Wage Index, https://www.ssa.gov/oact/cola/AWI.html

- A hypothetical worker who participates in a **high-cost plan with between $1 million and $10 million in assets for 40 years** could retire with approximately **$298,000 less** than if this worker participated in a **similarly-sized low-cost plan**. To make up this difference, a worker earning the average national wage would need to work for more than **4.6 years longer**.

Our analysis of privately available data yielded consistent results. Using information published by the 401(k) Average Book,[4] which provides benchmarking information for plans of different sizes, we found that:

- A hypothetical worker who participates in a **high-cost plan with 50 participants and $2.5 million in assets for 40 years** could retire with approximately **$342,000 less** than if the worker participated in a **low-cost plan of this size**. To make up this difference, a worker earning the average national wage would need to work for more than **5.3 years longer**.

Next, using information published by Employee Fiduciary, a low-cost retirement service provider, we found that:

- A hypothetical worker who participates in an **average-cost plan with 22 participants and $1.2 million in assets for 40 years** could retire with approximately **$251,000 less** than if the worker participated in a **low-cost plan of this size**. To make up this difference, a worker earning the average national wage would need to work for almost **4 years longer**.

The fees in a significant number of small company retirement plans are so high that they eliminate the tax benefit associated with investing in a tax deferred plan. Relying on the assumptions and analysis that Professors Ian Ayres and Quinn Curtis provided in their research paper on retirement plan fees,[5] we find that a participant in an average-cost (or worse) plan with less than $1 million in assets would be better off investing outside the 401(k) after any employer-provided match. In addition, participants in a significant percentage of plans with between $1 million and $10 million in assets would be better off investing outside the 401(k) after any employer-provided match.

Based on the limited data that is available, it is likely that **hundreds of thousands of plans** and **millions of retirement savers** are likely affected by high fees in their retirement plans.

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[4] 401(k) Averages Book, 23rd Edition.
[5] Ian Ayres & Quinn Curtis, Beyond Diversification: The Pervasive Problem of Excessive Fees and "Dominated Funds" in 401(k) Plans, Yale Law Journal, March 2015, https://www.yalelawjournal.org/article/excessive-fees-and-dominated-funds-in-401k-plans.

I. Background

One benefit that many employers provide to their workers is access to a workplace retirement plan, such as a 401(k), to help workers save and invest for retirement. As sponsors of those plans, employers are legally responsible for managing those plans solely in the interest of plan participants.[6] Sponsors are also required to ensure that their retirement plans have reasonable fees. Because workers often pay all or almost all of the costs associated with participating in their workplace retirement plans, including the investment costs and the administrative costs, workers depend on their employers to make careful and sound decisions about setting up and administering the plan, and the investment options to include in the plan lineup.

Employers' decisions matter because the cost and quality of plans can have a profound impact on a saver's ability to grow their nest egg over the course of their career. If the plan has high costs relative to available alternatives, workers' overall returns will suffer.[7] When it comes to investing, even seemingly small differences in investment-related fees can add up over time due to the nature of compounding.[8] This is because investors don't just lose the money associated with the higher costs that they pay for their investments; they also lose the potential returns they could have received if they didn't pay those higher costs and instead put that money to work.[9] This could mean the difference of hundreds of thousands of dollars in lost savings over time. As a practical matter, this could mean retiring with less money than a worker otherwise would have if he or she invested in lower-cost

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[6] Under the Employee Retirement Income Security Act of 1974, sponsors of retirement plans are fiduciaries. A fiduciary under ERISA must discharge his/her duties with respect to a plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan. In addition, a fiduciary is required to discharge his/her duties with respect to a plan with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. A fiduciary is also generally required to diversify the investments of the plan so as to minimize the risk of large losses and act in accordance with the documents and instruments governing the plan. 29 U.S. Code §1104 - Fiduciary duties.

[7] A substantial body of academic research suggests that costs and performance are generally inversely related, meaning that, as a general rule, higher cost investments perform worse than lower cost investments. See, e.g., "The Relation between Price and Performance in the Mutual Fund Industry." The authors found that "there is a negative relation between funds' before-fee performance and the fees they charge to investors." Javier Gil-Bazo and Pablo Ruiz-Verdú, The Journal of Finance, Vol. 64, No. 5 (Oct., 2009), pp. 2153-2183, https://onlinelibrary.wiley.com/doi/10.1111/j.1540-6261.2009.01497.x

[8] SEC, Office of Investor Education and Advocacy, Investor Bulletin, How Fees and Expenses Affect Your Investment Portfolio, https://www.sec.gov/investor/alerts/ib_fees_expenses.pdf ("Ongoing fees can also reduce the value of your investment portfolio. This is particularly true over time, because not only is your investment balance reduced by the fee, but you also lose any return you would have earned on that fee. Over time, even ongoing fees that are small can have a big impact on your investment portfolio."). See also U.S. Department of Labor, Employee Benefits Security Administration (EBSA), A Look at 401(k) Plan Fees, https://www.dol.gov/sites/dolgov/files/ebsa/about-ebsa/our-activities/resource-center/publications/a-look-at-401k-plan-fees.pdf ("While contributions to your account and the earnings on your investments will increase your retirement income, fees and expenses paid by your plan may substantially reduce the growth in your account which will reduce your retirement income.... the cumulative effect of the fees and expenses on your retirement savings can be substantial."). See also Pew Charitable Trusts, Small Differences in Mutual Fund Fees Can Cut Billions From Americans' Retirement Savings, June 30, 2022,https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2022/06/small-differences-in-mutual-fund-fees-can-cut-billions-from-americans-retirement-savings

[9] *Id.*

options or needing to work longer to meet their savings goals. While retirement plan costs have decreased in recent years, current costs are nonetheless substantial and are eroding retirement savers' portfolios.

Recent research has documented the problem of high fees in 401(k) plans costing 401(k) participants significant sums of money annually. For example, a study by Professors Ian Ayres of Yale Law School and Quinn Curtis of the University of Virginia School of Law, published in the Yale Law Journal, found that a significant portion of 401(k) plans have investment menus that predictably lead investors to hold high-cost portfolios.[10] In the study, the authors examined more than 3,500 401(k) plans with more than $120 billion in assets. Based on their analysis, the authors concluded that fees and menu restrictions in an *average plan* lead to a cost of 78 basis points (0.78 percent) in excess of the cost of index funds. As the authors explained, "Since investors in retirement plans are limited to choosing from the menu offered by their employers, high-cost funds in the menu can greatly affect the performance of a retirement account."[11]

The problem of excessive fees is "especially acute in small company plans, where there is less competition and fewer resources are likely to be devoted by the plan sponsor to administering the plan," according to Ayres and Curtis.[12] Further, they found that investors in many plans bear costs well in excess of retail index funds that "are unlikely to be fully mitigated by returns."[13] In 16 percent of the plans that they analyzed, which included plans of all sizes, not just small plans, Ayres and Curtis estimated that fees are so high "that they consume the tax benefits of investing in a 401(k) for a young employee."[14]

Similarly, a recent analysis by Morningstar also showed that small company retirement plans and their participants pay significantly higher fees than larger plans.[15] When examining the retirement plan landscape, Morningstar found that, "People who work for smaller employers and participate in small plans pay around double the cost to invest as participants at larger plans—around 88 basis points in total compared with 41 basis points, respectively. Small plans also feature a much wider range of fees between plans, with more than 30% of plans costing participants more than 100 basis points in total. Further, many plans are still outliers, with unusually high fees relative to their peers, particularly outside of the largest thousand or so plans in the U.S. In short, the U.S. system does not work nearly as

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[10] Ian Ayres & Quinn Curtis, Beyond Diversification: The Pervasive Problem of Excessive Fees and "Dominated Funds" in 401(k) Plans, Yale Law Journal, March 2015, https://www.yalelawjournal.org/article/excessive-fees-and-dominated-funds-in-401k-plans.
[11] *Id.*
[12] *Id.*
[13] *Id.*
[14] *Id.*
[15] Morningstar, Retirement Plan Landscape Report, An In-Depth Look at the Trends and Forces Reshaping U.S. Retirement Plans, March 2022, 17-19, https://www.nrmlaonline.org/wp-content/uploads/2022/03/Retirement-Plan-Landscape-Report.pdf

well for people who are not fortunate enough to work for larger, established employers."[16] In a companion blog, Morningstar's John Rekenthaler provided additional information about the costs that small plans pay, stating, "Fifteen percent of all small plans are burdened with cripplingly high annual 401(k) expenses of greater than 1.40%."[17]

This paper seeks to contribute to the research on small company retirement plan fees and quantify how significant these fees can be for retirement savers over the course of their careers.

II. Small Employers and the Retirement Plan Marketplace

Small employers are much less likely to offer a retirement plan than large employers. According to John Sabelhaus, 78 percent of workers at firms with fewer than 10 employees do not have a workplace retirement plan, while 34 percent of workers at firms with 1,000 or more employees do not have such a plan.[18] According to research by the Pew Charitable Trusts, owners of small business want to provide retirement benefits because it is the "right thing to do."[19] However, small employers find that the cost of starting a plan as well as the administrative requirements are barriers to do so.[20] When they decide to provide a retirement plan, they often are not aware of the different plan types, including many plan types that are low-cost and designed for small employers, such as the SIMPLE plan.[21]

For employers that do offer plans to their workers, the small employer market for retirement plan products and services is dominated by insurance firms.[22] Among retirement plans with less than $1 million in assets, insurance companies provide recordkeeping services to 50 percent of plans.[23] For plans with between $1 million and $10 million in assets, insurance companies provide recordkeeping services to 57 percent of plans.[24] In contrast, insurance companies provide services to less than 20 percent of employer plans with $500 million or more in assets.[25] As a result, the cost and quality of products and services for small plans are driven largely by the insurance industry.

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[16] Morningstar, Retirement Plan Landscape Report, An In-Depth Look at the Trends and Forces Reshaping U.S. Retirement Plans, March 2022, 17-19, https://www.nrmlaonline.org/wp-content/uploads/2022/03/Retirement-Plan-Landscape-Report.pdf
[17] John Rekenthaler, The System Still Fails Small 401(k) Plans, Morningstar, March 3, 2022, https://www.morningstar.com/articles/1082795/the-system-still-fails-small-401k-plans ("The marketplace is fundamentally flawed. It thrusts small businesses into a role that they mostly play poorly, by forcing them to become investment and legal authorities in establishing 401(k) plans. As four decades of 401(k) experiences have demonstrated, that is asking too much.").
[18] John Sabelhaus, The Current State of U.S. Workplace Retirement Plan Coverage, Wharton Pension Research Council Working Papers, March 2022, https://repository.upenn.edu/prc_papers/726.
[19] The Pew Charitable Trusts, Employer Barriers to and Motivations for Offering Retirement Benefits, June 21, 2017, https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2017/06/employer-barriers-to-and-motivations-for-offering-retirement-benefits.
[20] *Id.*
[21] *Id.*
[22] The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2020, September 2023, Exhibit 3.2, https://www.ici.org/system/files/2023-09/23-rpt-dcplan-profile-401k.pdf.
[23] *Id.*
[24] *Id.*
[25] *Id.*

The vast majority of plans in existence are small plans. Roughly 334,000 plans comprising more than 54 percent of plans have less than $1 million in assets.[26] Another 236,000 plans comprising more than 38 percent of plans have between $1 million and $10 million in assets.[27] Together, 570,000 plans comprising 92 percent of plans have less than $10 million in assets. There are more than 5.5 million participants in plans with less than $1 million and more than 13.2 million participants in plans with between $1 million and $10 million.[28] Together, close to 19 million participants are in plans with less than $10 million in assets.[29] In addition, 23 percent of 401(k) plans have assets of $250,000 or less, and another 30 percent have plan assets between $250,001 and $1,250,000, according to ICI.[30] Moreover, 63 percent of plans have 25 or fewer participants, and 24 percent have 26 to 100 participants.[31]

Employers who sponsor workplace retirement plans are fiduciaries, legally responsible for managing those plans solely in the interest of plan participants.[32] As fiduciaries, sponsors are required to ensure that their retirement plans have reasonable fees. However, plan sponsors often lack a sophisticated understanding of their role as fiduciaries, which is likely to negatively affect plan participants regarding the costs that they pay and the returns that they receive. And smaller employers usually do not have an in-house staff of human resource professionals with retirement expertise.

The Government Accountability Office (GAO) released a study in 2008 that examined plan sponsors' knowledge and ability to comply with their fiduciary obligations, finding serious shortcomings.[33] Based on a survey of industry professionals, the GAO reported that, "Several pension practitioners observed that most sponsors, especially sponsors of small plans, have very little fiduciary knowledge."[34]

Since that GAO study was published, several recent surveys have gauged employers' understanding of their legal obligations as fiduciaries and "documented this dangerous ignorance" about their fiduciary duties, according to a February 2018 Pensions and Investments editorial.[35] For example, the article cited to an AllianceBernstein LP survey that asked 1,000 defined contribution plan executives, all of whom were fiduciaries, if they were fiduciaries: 49 percent answered no and 6 percent didn't know. The article also cited to

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[26] *Id.* at Exhibit 1.2.
[27] *Id.*
[28] *Id.*
[29] The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2020, September 2023, Exhibit 1.3, https://www.ici.org/system/files/2023-09/23-rpt-dcplan-profile-401k.pdf
[30] ICI Research Perspective, 401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2020, November 2022 // VOL. 28, NO. 11, https://www.ici.org/system/files/2022-11/per28-11.pdf
[31] *Id.*
[32] *See supra* note 6.
[33] GAO, Private Pensions, Fulfilling Fiduciary Obligations Can Present Challenges for 401(k) Plan Sponsors, July 2008, http://bit.ly/2prHMcS.
[34] *Id.* at 23.
[35] Editorial, Pensions&Investments, February 19, 2018, https://www.pionline.com/article/20180219/PRINT/180219902/no-excuse-for-fiduciary-ignorance ("This lack of knowledge of what makes a fiduciary is dangerous for those executives because fiduciaries can be personally liable for losses suffered by plan participants as a result of breach of fiduciary duties.").

a similar survey by J. P. Morgan Asset Management that found that 43 percent of respondents did not know if they were fiduciaries or believed they were not. Similarly, a survey by MassMutual found that one-third of plan sponsors mistakenly say they are not a fiduciary to their plan; 15 percent don't know whether they are a fiduciary to their plan; and about 2 out of 10 sponsors who work with an adviser are not sure whether they or their adviser is a fiduciary to their plan.[36]

In addition, many small-business owners and managers don't have a good feel for how much they or their employees pay in fees to their retirement plans, according to a 2018 survey conducted by The Pew Charitable Trusts.[37] Only 19 percent of the small to midsize business leaders said they were "very familiar" with their retirement plan fees, while 34 percent said they were "not at all familiar" with those fees, according to the survey.[38] "The survey results indicate that many of these business leaders—like many workers—have limited knowledge about plan fees, a reality that can be detrimental to workers' long-term finances," the report concluded.

Without particular expertise in setting up and administering retirement plans, many small business employers turn to financial professionals for advice and recommendations on the products and services they should offer their workers.[39] These financial professionals are not typically legally required, under either ERISA[40] or the securities laws,[41] to act in the best interest of the plan or its participants when providing advice or recommendations to the plan sponsor. They often have conflicts of interest to recommend the products and services that compensate them the most, rather than the ones that are optimal for the plan and its participants. It can be very difficult for employers to assess the nature or extent of these conflicts of interest, factor these conflicts of interest into their decision making, or independently assess the quality of the advice and recommendations they receive. As a result, they often rely on the advice and recommendations they receive, potentially to the detriment of their workers.

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[36] MassMutual, DOL Fiduciary Rule, Winning Combination Study, 2015, http://bit.ly/2pB4b6u.
[37] John Scott and Sarah Spell, Many Small-Business Leaders Express Limited Knowledge of Retirement Plan Fees, Pew Charitable Trusts, May 7, 2018, https://www.pewtrusts.org/en/research-and-analysis/articles/2018/05/07/many-small-business-leaders-express-limited-knowledge-of-retirement-plan-fees
[38] *Id.*
[39] *See* GAO, 401(k) Plans, Improved Regulation Could Better Protect Participants from Conflicts of Interest, January 2011, http://bit.ly/2p3UIZk (Plan sponsors and plan officials that rely on biased advice "may make poor investment decisions," which can in turn compromise participants' retirement security.). See also Letter from American Retirement Association, to the SEC, December 2018, https://www.sec.gov/comments/s7-07-18/s70718-4767567-176840.pdf ("Broker-dealers routinely advise fiduciaries of small retirement plans concerning the investments that will be made available to participants under such plans. Like individual investors, most small plan business owners acting as retirement plan fiduciaries are not sophisticated investors. Most simply do not have retirement plan investment expertise.").
[40] The current regulatory definition of investment advice fiduciary under ERISA requires advice to be provided on a "regular basis." Because recommendations to include certain investments in a plan lineup usually happen once, financial firms and their professionals are not considered fiduciaries. Similarly, the rule requires there to be a "mutual agreement" that the advice will form a "primary basis" for the investment decision. Firms may include fine-print legal disclaimers in their materials stating that investors should not rely on the firm's advice as a primary basis for the decision. As a result, firms and their financial professionals are typically not considered fiduciaries under ERISA.
[41] Regulation Best Interest requires broker-dealers to provide securities recommendations in the best interest of retail customers. It does not apply to broker-dealers' recommendations to workplace retirement plans.

III. Retirement Savers Lack Knowledge of Plan Fees or Their Cumulative Impact Over Time

Survey data also shows that a significant portion of retirement plan participants do not understand retirement plan fee disclosures and lack knowledge of the real-world impact of investment fees.[42] For example, in a recent survey, the GAO assessed retirement savers' understanding of sample fee disclosures and asked general knowledge questions about fees.[43] The GAO found that a significant percentage of 401(k) plan participants do not fully understand and have difficulty using the fee information that the Department of Labor requires plans to provide plan participants in fee disclosures. For example, the GAO found that 45 percent of participants are not able to use the information given in disclosures to determine the cost of their investment fees.[44]

The GAO also found that retirement savers have a difficult time understanding the effect of asset-based investment fees on their returns. For example, approximately 63 percent of respondents did not understand that asset-based investment fees reduce returns.[45] Similarly, 53 percent of participants did not understand that the balance of an account with higher annual fees was not just lower but lower by a greater proportion over time.[46]

In addition, the GAO found that retirement savers lack knowledge about the fees that they pay for their own retirement plans. Based on responses from their survey, the GAO estimated that 64 percent of participants believe they are either not paying any 401(k) fees —administrative or investment fees—or do not know if they are paying these fees.[47]

Unsurprisingly, the GAO survey also found that retirement savers lack confidence in their ability to understand the effect of 401(k) fees on their retirement savings. Specifically, 58 percent of participants believed they are not knowledgeable about the impact fees can have on their total retirement savings, according to the survey results.[48]

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[42] *See, e.g.,* Judy T. Lin, Christopher Bumcrot, Gary Mottola, Olivia Valdes, Gerri Walsh, Investors in the United States: The Changing Landscape A Report of the FINRA Foundation National Financial Capability Study December 2022, https://www.finrafoundation.org/sites/finrafoundation/files/NFCS-Investor-Report-Changing-Landscape.pdf ("Many investors are unaware of or confused about various fees they may pay for investing. Over one in five investors (21 percent) do not think they pay any kind of fee for investing, and 17 percent say they do not know how much they pay. Among mutual fund owners, nearly two in five (38 percent) believe they do not pay mutual fund fees or expenses."). See also Pew Charitable Trusts, Many Workers Have Limited Understanding of Retirement Plan Fees, November 15, 2017, https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2017/11/many-workers-have-limited-understanding-of-retirement-plan-fees (finding that 31 percent were not at all familiar with the fees.).
[43] GAO, 401(k) Retirement Plans, Many Participants Do Not Understand Fee Information, but DOL Could Take Additional Steps to Help Them, July 2021, https://www.gao.gov/assets/720/715985.pdf
[44] *Id.* at 9.
[45] *Id.* at 13-14.
[46] *Id.* at 38.
[47] *Id.* at 41.
[48] *Id.* at 44-45.

Retirement savers' lack of understanding about fees may be due to the fact that DOL fee disclosures do not require plans to provide the actual cost of the fees that retirement savers pay. When asked about their preferences for seeing their asset-based investment fees, the vast majority of participants—83 percent—stated that they would prefer for plans to provide the actual cost of their asset-based investment fees, according to the survey results.[49]

IV. Participants in Smaller 401(k) Plans Pay Significantly Higher Fees Than Participants in Larger 401(k) Plans

At the outset, it's important to recognize that there is currently no way to systemically analyze fees for all plans and participants with complete accuracy and reliability. This is because existing regulatory reporting requirements for retirement plans do not provide sufficient information for the Department of Labor, retirement savers, researchers, and the general public to understand the full scope of the problem of excessive fees and to compare them with other offerings in the market.

While all plans report some information to the Department of Labor on Form 5500 on an annual basis, plans of different sizes have different reporting obligations.[50] Specifically, plans with fewer than 100 participants are generally not required to file as much information about their operations as plans with 100 participants or more. Yet the vast majority of 401(k) plans have fewer than 100 participants.[51] Plans with 100 participants or more are required to file audited Form 5500 reports with the DOL, which include some information about plan investments, the amount of assets in each investment, and the associated costs of the plan. However, even these plans are not required to report sufficiently detailed information about the particular costs that participants or the plan are paying. For example, plans that report information about their investments are not required to report the specific share classes of investments used in the plan or their accompanying expenses, despite the fact that there can be significant variation in cost between different share classes.[52] Because it's often

[49] *Id.* at 16-17.

[50] According to the DOL, "The Form 5500 Series is an important compliance, research, and disclosure tool for the Department of Labor, a disclosure document for plan participants and beneficiaries, and a source of information and data for use by other Federal agencies, Congress, and the private sector in assessing employee benefit, tax, and economic trends and policies. The Form 5500 Series is part of ERISA's overall reporting and disclosure framework, which is intended to assure that employee benefit plans are operated and managed in accordance with certain prescribed standards and that participants and beneficiaries, as well as regulators, are provided or have access to sufficient information to protect the rights and benefits of participants and beneficiaries under employee benefit plans." U.S. Department of Labor, Form 5500 Series, https://www.dol.gov/agencies/ebsa/employers-and-advisers/plan-administration-and-compliance/reporting-and-filing/form-5500

[51] Out of more than 616,000 401(k) plans, more than 550,000 or those have fewer than 100 participants. Out of approximately 570,000 plans with less than $10 million in assets, approximately 543,000 plans do not file audited information. The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2020, September 2023, https://www.ici.org/system/files/2023-09/23-rpt-dcplan-profile-401k.pdf Exhibit 1.2 and 1.3.

[52] Letter from Ryan Alfred, Brightscope, to the Department of Labor, December 2, 2016, http://bit.ly/2pC7Cdf. ("BrightScope observes that about 50% of the investment information in the Department's audit reports currently do not have share class information. Therefore any person or firm evaluating a plan based on the current disclosures would have to make share class assumptions, which limits the accuracy of any performance or fee analysis of the plan. It is not uncommon for a single fund to have 10+ share classes and the range of expense ratios across those share classes to exceed 1%. BrightScope uses human assumptions and computer algorithms to determine fee levels when share class information is not present. BrightScope's

impossible to gain a precise understanding from Form 5500s of the costs plans and their participants are paying, any analysis of Form 5500s may not be accurate or reliable.

Every year, ICI/Brightscope publishes a study on 401(k) plan attributes, known as the Defined Contribution Plan Profile: A Close Look at 401(k) Plans.[53] ICI/BrightScope's Defined Contribution Plan Database, which relies on Form 5500 data, is likely to suffer from these reporting issues. For example, only 0.9 percent of 401(k) plans with less than $1 million in assets and 10.4 percent of plans with between $1 million and $10 million are in their database.[54] In addition, because plans are not required to report the specific share classes of investments used in the plan or their accompanying expenses, and many plans don't report such information, ICI/Brightscope's analysis of plan investment fees may not be accurate or reliable. According to Brightscope's CEO, "BrightScope's current policy of giving the plan sponsor the benefit of the doubt when it makes share class assumptions means we may be systematically underestimating plan fees, to the detriment of the participants in those plans."[55]

Because of these potential issues with the publicly available data, we have supplemented publicly available data with analysis of data that is privately available. This data does not rely on Form 5500 information. Rather, it relies on information from plan recordkeepers and plan sponsors. However, because the data used is not comprehensive and may not be fully representative of the market, any analysis of the data used may suffer from its own reliability issues. That is, the data may not be generalizable to the larger population of similarly-sized plans.

Despite potential issues with the data that we rely on for this report, all of the available evidence strongly suggests that millions of participants in hundreds of thousands of small plans are afflicted by excessive fees.

While there are various ways of analyzing fees,[56] regardless of the analytical approach used to compute costs, the evidence overwhelming shows that total fees are on average

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current policy of giving the plan sponsor the benefit of the doubt when it makes share class assumptions means we may be systematically underestimating plan fees, to the detriment of the participants in those plans.").

[53] The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2020, September 2023, https://www.ici.org/system/files/2023-09/23-rpt-dcplan-profile-401k.pdf

[54] *Id.* at Exhibit I.5

[55] Letter from Ryan Alfred, Brightscope, to the Department of Labor, December 2, 2016, [35] eXp Realty, eXp Mentor Program: What is the Mentor Program? What is a Certified Mentor? Mentee Expectation Checklist..

[56] The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2020, September 2023, at 49, https://www.ici.org/system/files/2023-09/23-rpt-dcplan-profile-401k.pdf ("Fees can be calculated at the plan level (where each plan is treated equally), at the participant level (where each participant is treated equally), or at the asset level (where each dollar is treated equally). Because the average plan tends to be small and the average participant and average dollar are in larger plans, the focus of the fee analysis can produce different answers."). We have focused on plan-weighted expenses because we are considering the average small plan experience. However, analyzing participant-weighted expenses, which focus on the average participant experience, yields similar results. *See* Exhibit 4.1 (showing total plan-weighted, participant-weighted, and asset-weighted averages for plans below $1 million in assets to be clustered together at 1.26 percent, 1.23 percent, and 1.27 percent, respectively. Plans with between $1 million and $10 million in assets have total plan-weighted, participant-weighted, and asset-weighted averages of 1.01 percent, 1.12 percent, and 0.96 percent, suggesting the average participant in these plans is paying much higher costs than the average plan offers or where the average asset is held.).

considerably higher for small plans and their participants than large plans and their participants.[57] Our analysis focuses on the total costs associated with participating in a plan, which include investment-related expenses and administrative expenses. Similar to other employee benefits, such as health insurance, employers determine whether employees, the employer, or both pay for administrative expenses.[58] Survey research suggests that most plans, irrespective of size, pass administrative expenses on to employees.[59] Survey research also suggests that small plans under $1 million in assets pass a greater percentage of costs on to participants than the broader marketplace.[60] Moreover, those administrative costs are generally a greater percentage of plan assets, given that there are fewer participants to spread these costs between.[61]

There are several reasons why total fees are higher for smaller plans, including that larger plans benefit from economies of scale that allow the administrative costs of running the plan to be spread between more plan participants. Another reason is that larger plans tend to have a greater share of their assets invested in index funds, which tend to have lower expenses than other types of investments.[62] In addition, larger plans tend to have plan sponsors that are typically more financially sophisticated than smaller plans. Larger plans may even have investment professionals, either in-house or through the use of consultants, with particularized expertise in plan administration and retirement investing.

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[57] *Id*., at 48 ("larger plans tend to have a lower total plan cost when measured as a percentage of plan assets").

[58] Administrative expenses can be paid directly by the employer or by the employees, such as by an annual flat fee or asset-based fee. Alternatively, administrative expense can be paid indirectly by employees through the investments that are offered in the plan. This is known as revenue sharing. Different share classes of mutual funds have different revenue sharing arrangements, with different costs for participants, which is why the lack of specificity with regard to Form 5500 reports is relevant.

[59] ICI Research Perspective, The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2019, JULY 2020, VOL. 26, NO. 5, Figure A1, https://www.ici.org/system/files/attachments/per26-05.pdf. How Are Plan Recordkeeping and Administrative Fees Paid? Percentage of 401(k) and 403(b) plans surveyed, 2019 (33 percent of surveyed plans paid through investment revenue, 15 percent paid through a wrap fee or added basis point charge on investments, and in 52 percent of plans, the recordkeeper charges a direct fee. Among plans with a direct recordkeeping fee, 25 percent report that the plan sponsor pays the fee, 12 percent report that both the plan sponsor and the participants pay the fee, 28 percent allocate the fee to participants as an equal flat dollar amount, and 29 percent allocate the fee to participants pro rata based on account balances. Source: Deloitte Consulting LLP 2019). https://www2.deloitte.com/content/dam/Deloitte/us/Documents/human-capital/us-2019-defined-contribution-benchmarking.pdf In addition, while dated, survey data from 2011 found that, on average, participants pay 91 percent of total plan fees while employers pay 5 percent and plans cover 4 percent. Deloitte Consulting LLP, Inside the Structure of Defined Contribution/401(k) Plan Fees: A Study Assessing the Mechanics of the 'All-In' Fee, November 2011, https://www.idc.org/doc-server/pdf%3Arpt_11_dc_401k_fee_study.pdf

[60] Deloitte Consulting LLP, Inside the Structure of Defined Contribution/401(k) Plan Fees: A Study Assessing the Mechanics of the 'All-In' Fee, November 2011, Exhibit 24, https://www.idc.org/doc-server/pdf%3Arpt_11_dc_401k_fee_study.pdf (participants pay 100 percent of total plan fees for plans with less than $1 million in assets, while participants pay 87 percent of total plan fees for plans with between $1 million and $10 million in assets.).

[61] Given that small employers typically lack both the financial sophistication to understand these cost structures and the financial resources to pay these costs even if they did understand them, we believe it is reasonable to assume that the vast majority of small plans continue to pass all or almost all of the total expenses plans charge to employees. We have therefore assumed that participants pay all of the costs associated with participating in their 401(k). We recognize that this assumption does not apply for all plans, however.

[62] The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2020, September 2023, at 48, https://www.ici.org/system/files/2023-09/23-rpt-dcplan-profile-401k.pdf

As shown below, we've constructed illustrations on how hypothetical workers who participate in different size small company plans with average fees could fare, relative to how they would fare if they were in a large plan with average fees.[63] We found that a hypothetical worker who participates in average-cost small company plans with less than $10 million in assets would lose out on hundreds of thousands of dollars of growth over their career relative to a hypothetical worker who participates in an average-cost large company plan.

Comparing Average Plan Costs for Different Size Plans

Using publicly available data published by ICI/Brightscope,[64] we found that:

- A hypothetical worker who participates in an **average-cost plan with less than $1 million in assets for 30 years** could retire with approximately **$102,000 less** than if this worker participated in an **average-cost plan with more than $1 billion in assets**.[65] To make up this difference, a worker earning the average national wage of $63,795[66] would need to work for a little more than **1.5 years longer**.
- A hypothetical worker who participates in an **average-cost plan with less than $1 million in assets for 40 years** could retire with approximately **$292,000 less** than if this worker participated in an **average-cost plan with more than $1 billion in assets**. To make up this difference, a worker earning the national average wage would need to work **4.5 years longer**.
- A hypothetical worker who participates in an **average-cost plan with between $1 million and $10 million in assets for 30 years** could retire with approximately **$78,000 less** than if this worker participated in an **average-cost plan with more than $1 billion in assets**. To make up this difference, a worker earning the national average wage would need to work **1.2 years longer**.
- A hypothetical worker who participates in an **average-cost plan with between $1 million and $10 million in assets for 40 years** could retire with approximately **$226,000 less** than if this worker participated in an **average-cost plan with more than $1 billion in assets**. To make up this difference, a worker earning the average national wage would need to work **3.5 years longer**.

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[63] All hypothetical illustrations consider a retirement saver who participates in a plan for 10, 20, 30, and 40 years, contributes $500 per month over those terms, and receives an average 7% real annual rate of return. All calculations are made using Pew Trusts, How Fees Affect Retirement Savings Over Time, An interactive illustration, DATA VISUALIZATION, October 23, 2018, https://www.pewtrusts.org/en/research-and-analysis/data-visualizations/2018/how-fees-affect-retirement-savings-over-time?track=your-investment&slide=your-investment-plan.
[64] Total plan cost is BrightScope's measure of the total cost of operating the 401(k) plan and includes asset-based investment management fees, asset-based administrative and advice fees, and other fees (including insurance charges) from the Form 5500 and audited financial statements of ERISA-covered 401(k) plans.
[65] The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2020, September 2023, Exhibit 4.1, upper panel, plan-weighted, https://www.ici.org/system/files/2023-09/23-rpt-dcplan-profile-401k.pdf
[66] Based on the Social Security national average wage index, based on 2022 data. Social Security National Average Wage Index, https://www.ssa.gov/oact/cola/AWI.html

Plan Size / Costs	Balance at 10 years	Balance at 20 years	Balance at 30 years	Balance at 40 years
Less than $1 million (Annual Cost 1.26 percent plan-weighted average)	$81,147	$224,911	$479,606	$930,832
Between $1 million-$10 million (Annual Cost 1.01 percent plan-weighted average)	$82,277	$231,736	$503,231	$996,407
$1 billion (Annual Cost 0.27 percent plan-weighted average)	$85,739	$253,455	$581,528	$1,223,277

V. Differences in Fees for Similarly-Sized Small Company Retirement Plans Can Be Staggering

While larger plans tend to have lower fees than smaller plans as a percentage of plan assets, plan size alone does not determine the cost of a retirement plan. Indeed, cost-effective small company retirement plans are available in the marketplace such that a low-cost small company retirement plan can compete with a large plan on a cost basis.

Recent research has documented wide variation in costs between similarly-sized small company retirement plans. For example, in their study, Professors Ayres and Curtis found that the "observed costs do not appear to be due to economies of scale; we find substantial variation in total costs over plans of similar size."[67] Similarly, Morningstar found that, "The spread of fees plan participants pay is particularly wide among smaller plans.…The distribution of total costs for small plans is much wider than for larger ones, meaning any given worker is much more likely to be in an expensive plan if she works for an employer with a small plan."[68] Morningstar also observed that, "Nonetheless, not all small plans are expensive. Some employers with small plans report total costs that are competitive with larger plans."[69]

Our analysis of publicly and privately available data confirms these findings. As shown below, we've constructed illustrations on how hypothetical workers who participate in small company plans with different fees could fare, using the same assumptions as above. For the following analysis, we used publicly available data published by ICI/Brightscope.[70]

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[67] Ian Ayres & Quinn Curtis, Beyond Diversification: The Pervasive Problem of Excessive Fees and "Dominated Funds" in 401(k) Plans, Yale Law Journal, March 2015, https://www.yalelawjournal.org/article/excessive-fees-and-dominated-funds-in-401k-plans ("Put differently, a very pricey plan can be nearly twice as expensive as a plan of similar size with very low costs. Clearly, size does not explain all of the variation in plan cost.").
[68] Morningstar, Retirement Plan Landscape Report, An In-Depth Look at the Trends and Forces Reshaping U.S. Retirement Plans, March 2022, 17-19, https://www.nrmlaonline.org/wp-content/uploads/2022/03/Retirement-Plan-Landscape-Report.pdf
[69] *Id.*
[70] The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2020, September 2023, Exhibit 4.2, https://www.ici.org/system/files/2023-09/23-rpt-dcplan-profile-401k.pdf

Comparing Differences in Costs and Balances Over Time for Plans with Less than $1 Million in Assets

- A hypothetical worker who participates in a **high-cost plan with less than $1 million in assets for 30 years** could retire with approximately **$202,000 less** than if this worker participated in a **low-cost plan with less than $1 million in assets**. To make up this difference, a worker earning the national average wage would need to work for a little more than **3 years longer**.
- A hypothetical worker who participates in a **high-cost plan with less than $1 million in assets for 40 years** could retire with approximately **$559,000 less** than if this worker participated in a **low-cost plan with less than $1 million in assets**. To make up this difference, a worker earning the national average wage would need to work for more than **8.7 years longer**.

Plan Size: Less than $1 million	Balance at 10 years	Balance at 20 years	Balance at 30 years	Balance at 40 years
Median Cost 1.02 percent	$82,232	$231,458	$502,260	$993,685
10th percentile Cost 0.20 percent	$86,076	$255,634	$589,639	$1,247,585
90th percentile Cost 2.40 percent	$76,236	$196,724	$387,153	$688,122

Comparing Differences in Costs and Balances Over Time For Plans with between $1 Million and $10 Million in Assets

- A hypothetical worker who participates in a **high-cost plan with between $1 million and $10 million in assets for 30 years** could retire with approximately **$106,000 less** than if this worker participated in a **similarly sized low-cost plan**. To make up this difference, a worker earning the national average wage would need to work for more than **1.5 years longer**.
- A hypothetical worker who participates in a **high-cost plan with between $1 million and $10 million in assets for 40 years** could retire with approximately **$298,000 less** than if this worker participated in a **similarly sized low-cost plan**. To make up this difference, a worker earning the national average wage would need to work for more than **4.6 years longer**.

Plan Size: Between $1 million-$10 million	Balance at 10 years	Balance at 20 years	Balance at 30 years	Balance at 40 years
Median Cost 0.96 percent	$82,506	$233,131	$508,117	$1,010,000
10th Percentile Cost 0.47 percent	$84,786	$247,352	$559,052	$1,156,698
90th Percentile Cost 1.56 percent	$79,817	$217,040	$452,954	$858,539

Our analysis of privately available data yielded consistent results. First, we considered information published by the 401(k) Average Book,[71] which provides benchmarking information for plans.

Comparing Differences in Costs and Balances Over Time for Plans with 50 Participants and $500,000 in Assets

- A hypothetical worker who participates in a **high-cost plan with 50 participants and $500,000 in assets for 30 years** could retire with approximately **$185,000 less** than if the worker participated in a **similarly sized low-cost plan**. To make up this difference, a worker earning the national average wage would need to work for almost **3 years longer**.
- A hypothetical worker who participates in a **high-cost plan with 50 participants and $500,000 in assets for 40 years** could retire with approximately **$482,000 less** than if the worker participated in a **similarly sized low-cost plan**. To make up this difference, a worker earning the national average wage would need to work **7.5 years longer**.

Plan Size: 50 participants/$500,000 in Assets	Balance at 10 years	Balance at 20 years	Balance at 30 years	Balance at 40 years
Average Cost: 2.19 percent	$77,112	$201,576	$402,472	$726,734
Low Cost: 0.84 percent	$83,057	$236,520	$520,074	$1,043,992
High Cost: 3.2 percent	$73,012	$179,513	$334,865	$561,476

Comparing Differences in Costs and Balances Over Time for Plans with 50 Participants and $2.5 Million in Assets

- A hypothetical worker who participates in a **high-cost plan with 50 participants and $2.5 million in assets for 30 years** could retire with approximately **$122,000 less** than if the worker participated in a **low-cost plan of this size**. To make up this difference, a worker earning the national average wage would need to work for almost **2 years longer**.
- A hypothetical worker who participates in a **high-cost plan with 50 participants and $2.5 million in assets for 40 years** could retire with approximately **$342,000 less** than if the worker participated in a **low-cost plan of this size**. To make up this difference, a worker earning the national average wage would need to work for more than **5.3 years longer**.

[71] 401(k) Averages Book, 23rd Edition.

Plan Size: 50 participants/$2.5 Million in Assets	Balance at 10 years	Balance at 20 years	Balance at 30 years	Balance at 40 years
Average Cost: 1.31 percent	$80,924	$223,575	$475,038	$918,314
Low Cost: 0.45 percent	$84,881	$247,954	$561,254	$1,163,170
High Cost: 1.73 percent	$79,075	$212,728	$438,626	$820,438

Comparing Differences in Costs and Balances Over Time for Plans with 50 Participants and $5 Million in Assets

- A hypothetical worker who participates in a **high-cost plan with 50 participants and $5 million in assets for 30 years** could retire with approximately **$127,000 less** than if the worker participated in a **low-cost plan of this size**. To make up this difference, a worker earning the national average wage would need to work **2 years longer**.
- A hypothetical worker who participates in a **high-cost plan with 50 participants and $5 million in assets for 40 years** could retire with approximately **$360,000 less** than if the worker participated in a **low-cost plan of this size**. To make up this difference, a worker earning the national average wage would need to work **5.6 years longer**.

Plan Size: 50 participants/$5 Million in Assets	Balance at 10 years	Balance at 20 years	Balance at 30 years	Balance at 40 years
Average Cost: 1.09 percent	$81,914	$229,525	$495,525	$974,868
Low Cost: 0.3 percent	$85,595	$252,528	$578,091	$1,213,022
High Cost: 1.58 percent	$79,729	$216,527	$451,240	$853,953

Comparing Differences in Costs and Balances Over Time
Average-Cost Plan vs. Low-Cost Plan with 22 Participants and $1.2 Million in Assets

Next, we considered information published by Employee Fiduciary, a retirement service provider that provides recordkeeping and Third-Party Administrator services to small businesses. Employee Fiduciary launched a no-cost 401(k) fee comparison service almost a decade ago.[72] As part of this fee comparison service, the company provides a report that totals all of the compensation a 401(k) plan pays service providers and fund companies into a single "all-in" fee. Importantly, this report is not based on the data provided in Form 5500. Rather, it is based on plans' 408(b)(2) fee disclosures, the plan's current fund lineup with total balances for each fund, and the participant count.[73] This provides more accurate cost information than the Form 5500 disclosures.

[72] Eric Droblyen, (Possibly) The Biggest Small Business 401k Fee Study Ever!, EMPLOYEE THE FIDUCIARY FRUGAL FIDUCIARY BLOG, August 24, 2016, http://bit.ly/2ogoDZr.
[73] This information must be supplied by the plan sponsor, as these documents are not publicly available.

In its most recent study, Employee Fiduciary analyzed 104 small business plans with less than $5 million in assets.[74] The average plan in the study had 22 employees and $1.2 million in assets and had an all-in average annual fee of 1.18 percent. Employee Fiduciary then compared that all-in fee to the all-in fee that a similarly sized plan would cost if it received services from Employee Fiduciary.[75]

Using the same assumptions as we have throughout this paper, we found that:

- A hypothetical worker who participates in an **average-cost plan of this size for 30 years** could retire with more than **$87,000 less** than if the worker participated in a **low-cost plan of this size**. To make up this difference, a worker earning the national average wage would need to work for almost **1.4 years longer**.
- A hypothetical worker who participates in an **average-cost plan of this size for 40 years** could retire with approximately **$251,000 less** than if the worker participated in a **low-cost plan of this size**. To make up this difference, a worker earning the national average wage would need to work for almost **4 years longer**.

Plan Size: 22 participants/$1.2 million	Balance at 10 years	Balance at 20 years	Balance at 30 years	Balance at 40 years
Average Cost Plan: 1.18 percent	$81,507	$227,068	$487,022	$951,266
Low-Cost Plan: 0.33 percent	$85,452	$251,605	$574,677	$1,202,863

VI. The High Costs of Many Small Company 401(k) Plans Erode the Tax Benefit of Investing in Those Plans

When Professors Ayres and Curtis examined a cross-section of the 401(k) market, they compared the tax benefit of investing in a 401(k) with investing outside of a 401(k), in order to obtain a useful point of comparison for plan fees. Specifically, they considered two investment accounts— a 401(k) retirement account holding an actively managed mutual fund[76] and a conventional brokerage account holding an exchange-traded index fund (ETF).[77] The authors then computed and compared the balance of each account at

[74] Eric Droblyen, 401(k) Fee Study: 75% of Small Business Plans Pay Hidden Fees, January 26, 2023, The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2020, September 2023, Exhibit 4.2, https://www.ici.org/system/files/2023-09/23-rpt-dcplan-profile-401k.pdf

[75] Eric Droblyen, How Much Lower 401(k) Fees Can Grow Your Retirement Savings, January 26, 2023, Id. (Employee Fiduciary calculates the average all-in fee the same plans would pay for Employee Fiduciary's services to be 0.33 percent. Using different assumptions than ours of a hypothetical 30 year old with a $50,000 balance making annual contributions of $10,000, investing for 35 years, and receiving a 7 percent annual return, Employee Fiduciary found that this hypothetical investor would have $382,380 in additional savings at age 65 due to the reduced fees).

[76] To be clear, the distinction between active and passive is irrelevant for purposes of this analysis. What is relevant is the difference in structure between and ETF and a mutual fund, the cost of each fund, and the value of deductions from each type of investment/account post-retirement. According to the authors, "The ETF assumption is critical here, because it is taxed when sold and does not distribute capital gains over the course of the investment period, as does a conventional mutual fund. This means that capital gains are fully deferred until retirement."

[77] Using an exchange-traded fund (ETF) was critical to the analysis because an ETF has the advantage of deferring most taxation until the ETF shares are sold, and so is more tax efficient than a mutual fund. Alternatively, saving in a traditional Individual Retirement Account (IRA) would defer all taxation until those investments are distributed.

retirement, for each dollar invested now, discounted by any taxes due on deductions from the account at the time of withdrawal.[78]

According to their analysis, an employee would be better off investing outside the 401(k) so long as the fees on the mutual fund exceed 1.03 percent.[79] Based on these assumptions, using publicly available data and assuming plan participants pay the total costs of participating in their retirement plan, a participant in an average plan with less than $1 million in assets, paying the average plan cost, would be better off investing outside the 401(k) after any employer-provided match, given that the total plan-weighted average cost for plans with less than $1 million in assets is 1.26 percent.[80]

In addition, participants in a significant percentage of plans with between $1 million and $10 million in assets would be better off investing outside the 401(k) after any employer-provided match, given that the total plan-weighted average cost for plans with between $1 million and $10 million is 1.01 percent, which is just below the 1.03 percent amount where an employee would be better off investing outside the 401(k).[81]

Evidence from privately available data yielded similar findings. First, data from the 401(k) Averages Book suggests that the total costs associated with an average plan with $5 million in assets and 50 employees exceed the tax benefit, given that the average cost for a plan of this size is 1.09 percent.[82] Second, data from Employee Fiduciary's most recent fee study analyzing 104 small business plans with less than $5 million in assets suggests that the costs for the average plan in this study, with 22 employees and $1.2 million in assets, exceed the tax benefit, given that a plan of this size had an all-in average annual fee of 1.18 percent.[83]

This data suggest that a significant number of small company retirement plans and workers are likely affected by excessive fees that eat into retirement savers' nest eggs and negate the tax benefit associated with participating in a 401(k). While comprehensive data about small company retirement plan costs are not generally publicly available, based on the limited data that is available, it is likely that hundreds of thousands of plans and millions of retirement savers are likely affected by excessive fees in small company retirement plans, given that there are roughly 570,000 plans with less than $10 million in assets, covering

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[78] Professors Ayres and Curtis found that 16 percent of the plans they analyzed has fees that were so high "that they consume the tax benefits of investing in a 401(k) for a young employee." Ian Ayres & Quinn Curtis, Beyond Diversification: The Pervasive Problem of Excessive Fees and "Dominated Funds" in 401(k) Plans, Yale Law Journal, March 2015, at 1481, https://www.yalelawjournal.org/article/excessive-fees-and-dominated-funds-in-401k-plans
[79] *Id.* at 1552.
[80] The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2020, September 2023, Exhibit 4.1, upper panel, plan-weighted, https://www.ici.org/system/files/2023-09/23-rpt-dcplan-profile-401k.pdf
[81] *Id.*
[82] 401(k) Average Book, 23rd Edition.
[83] Eric Droblyen, 401(k) Fee Study: 75% of Small Business Plans Pay Hidden Fees, January 26, 2023, https://www.employeefiduciary.com/blog/small-business-401k-fee-study-hidden-fees

close to 19 million participants.[84] In addition, 23 percent of 401(k) plans have assets of $250,000 or less, and another 30 percent have plan assets between $250,001 and $1,250,000, according to ICI.[85] Moreover, 63 percent of plans have 25 or fewer participants, and 24 percent have 26 to 100 participants.[86] The smallest plans and their participants are likely most vulnerable to these high costs.

VII. Responding to Potential Industry Criticism

Retirement plan service providers often defend their fees as reasonable by claiming that they provide value for their services in other ways, including by educating workers about the importance of saving for retirement, thereby increasing workers' participation in retirement plans and savings rates. When Professors Ayres and Curtis examined the data, however, it "hint[ed] that the opposite may be the case: it may be that costly plans discourage investor participation, reduce investor contributions, and produce poorer allocation decisions."[87] The authors found evidence that expensive plans actually have significantly lower employee participation. They also found that expensive plans have lower contributions per employee and that employees in expensive plans allocate their portfolios less effectively even before accounting for fees.

To the extent retirement plan service providers provide value for what are in many cases high-cost services, it is not immediately clear or tangible what that value is. At a certain point, the costs can be so high that it would be difficult, if not impossible, to provide sufficient value in order to justify those costs.

VIII. Takeaways

First, employers should reduce plan costs as much as possible both when starting a plan and through continuously reviewing plan costs and available alternatives. As noted above, surveys show that plan sponsors do not know about all the plan types available to them, including low-cost options for smaller firms, but they need to engage in that search. At the same time, small business owners are constrained in terms of time and resources, and even though they desire to provide benefits because "it's the right thing to do," the structure of the retirement plan market makes it difficult to shop for low-cost alternatives. Public policy might consider actions that raise awareness of low-cost plan alternatives.

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[84] There were almost 334,000 plans with less than $1 million in existence and there were more than 236,000 plans with between $1 million and $10 million. There were more than 5.5 million participants in plans with less than $1 million in existence and there were more than 13.2 million participants in plans with between $1 million and $10 million. The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2020, September 2023, Exhibit 1.3, https://www.ici.org/system/files/2023-09/23-rpt-dcplan-profile-401k.pdf
[85] ICI Research Perspective, 401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2020, November 2022 // VOL. 28, NO. 11, https://www.ici.org/system/files/2022-11/per28-11.pdf
[86] *Id.*
[87] Ian Ayres & Quinn Curtis, Beyond Diversification: The Pervasive Problem of Excessive Fees and "Dominated Funds" in 401(k) Plans, Yale Law Journal, March 2015, https://www.yalelawjournal.org/article/excessive-fees-and-dominated-funds-in-401k-plans

Moreover, retirement savers in all retirement plans should pay careful attention to the fees associated with their retirement plans. To the extent their plans have higher than average fees, retirement savers should demand that their employer provide better, lower-cost options. Low-cost options exist if employers search for them. Employers are, after all, legally required to manage plans in the sole interest of participants and ensure that plans pay no more than reasonable expenses.

Next, to the extent an employer doesn't take action with regard to a higher-than-average cost plan, it may not make sense for workers to invest in their plan beyond any employer-provided match, depending on whether the costs of the plan exceed the tax benefit. It may make more sense to invest in low-cost ETFs in a taxable brokerage account after receiving any employer-provided match.

Once a worker leaves a job, he or she may be better off rolling over a high-cost 401(k) to their new employer if their new employer's 401(k) has lower costs. Alternatively, a worker may be better off rolling over a high-cost 401(k) to an IRA with very low-cost options. However, workers and retirees should beware of conflicted financial professionals who try to steer them to investments and services that are not in their best interest. IRA investments often charge higher fees than the investments that may be available in employer-sponsored plans.[88]

Just as workers factor in other employee benefits when considering their employment decisions, workers should factor retirement plan costs into their employment decisions. The fact that working for an employer with a high-cost plan could cost that person hundreds of thousands of dollars in retirement savings over their career should at least cause them to think carefully about whether a potential job is worth those costs.

Finally, regulatory disclosures and reporting requirements should be enhanced. First, there is strong evidence that existing disclosures do not sufficiently inform retirement plan participants of the costs that they are paying for their retirement plans or the impact these costs could have over time. A significant percentage of 401(k) plan participants do not fully understand and have difficulty using the fee information that the Department of Labor requires plans to provide plan participants in fee disclosures. Retirement savers need better information regarding the potential costs they are paying, and that information should be displayed in ways that they are likely to understand. Specifically, the Department of Labor should update participant fee disclosures to show the impact of their plan's actual fees on participants' portfolios over time for different cost plans. This information should include

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[88] *See, e.g.*, Pew Charitable Trusts, Small Differences in Mutual Fund Fees Can Cut Billions From Americans' Retirement Savings, June 30, 2022, https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2022/06/small-differences-in-mutual-fund-fees-can-cut-billions-from-americans-retirement-savings (Employer-sponsored plans may be able to offer institutional class mutual fund shares, which often have lower costs than mutual funds in IRAs, which typically charge retail class fees).

benchmarks so participants can understand and compare the costs they are paying, relative to other plan offerings in the market.

Second, existing regulatory reporting requirements for retirement plans do not provide sufficient information for the Department of Labor, retirement savers, researchers, and the general public to understand the full scope of the problem of excessive fees in small retirement plans and to compare them with other offerings in the market. Most small plans are not required to provide detailed information about their plan operations, including their costs. Even large plans that are required to provide more detailed information are not required to provide enough information to know the exact amount of fees plans or their participants are paying. This lack of information perpetuates the problem of excessive retirement plan fees. Therefore, regulatory reporting requirements should be updated to ensure that plans report all of the fees that plans and their participants are paying, including the total costs, the specific costs of each investment in the plan and how many assets are in each investment, the administrative costs, and how all of these costs are allocated between the employer and their participants. This information would allow the Department of Labor, retirement savers, researchers, and the general public to understand the full scope of the problem, identify the worst plans, and hold employers that run such plans feet to the fire to get better options.