# WILL REGULATIONS TO REDUCE IRA FEES Work?

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### Introduction

As a result of rollovers from 401(k) plans, Individual Retirement Accounts (IRAs) have become the biggest form of retirement savings – bigger than 401(k)s. This development raises concerns because, compared to 401(k) regulatory safeguards, IRA investments have fewer protections. One consequence is that IRAs tend to be invested in mutual funds with higher fees. And fees have a significant effect on how much an individual will have at retirement.

Regulators contend that part of the explanation for the high fees on IRA investments is that third-party incentive payments, such as 12b-1 fees, encourage the selling of more expensive mutual funds. In response, in 2010, the U.S. Department of Labor (DOL) proposed to eliminate these incentive payments for anyone who gives advice to IRA holders (banks, insurance companies, Registered Investment Advisers, and broker-dealers).<sup>1</sup> The focus here is broker-dealers because they account for the bulk of IRA investments. The DOL proposal has met with a storm of criticism from the investment industry, which contends that eliminating fees could force brokers to charge directly for their advice and that raising the visibility of the cost of advice would result in less advice being provided to low- and moderate-income IRA holders. This *brief*, which is based on a new study, examines the tradeoff between lower fees and industry allegations of harm.<sup>2</sup>

The discussion proceeds as follows. The first section provides background on the nature of the IRA fee issue. The second section discusses the proposed changes in regulations. The third section presents estimates of the benefits and costs of eliminating 12b-1 fees and shifting IRA holders to lower-cost investments, using both a back-of-the-envelope approach and an inter-temporal optimization model. Both exercises point to relatively modest potential benefits from eliminating 12b-1 fees, but also little harm. Given the modest impact of the DOL proposal, the fifth section offers more extensive reform options, such as encouraging those with retirement savings to keep it in the 401(k) system, subjecting

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either roll-over transactions or all rollover IRAs to stricter fiduciary standards, and banning high-fee, actively-managed mutual funds from both 401(k)s and rollover IRAs.

## The Nature of the Problem

The problem is that the average individual who rolls over his 401(k) plan into an IRA enters a world in which broker-dealers face incentives to sell high-fee investments. Fees have a significant effect on how much an individual will have at retirement: an additional 100 basis points over a 40-year period reduces final assets by about one fifth.<sup>3</sup> Many studies have also shown that actively-managed funds underperform index funds, even before accounting for the higher fees charged by the former.<sup>4</sup> But broker-sold mutual funds perform worst of all. One estimate is that broker-sold funds underperform average activelymanaged stock funds by 23 to 255 basis points a year.<sup>5</sup> The problem is big because the number of people rolling over into IRAs has increased dramatically.

The demand for IRAs has grown significantly in the wake of the shift in retirement plans from defined benefit to defined contribution – typically 401(k)s. The increase in IRAs has occurred because individuals roll over their balances when they shift jobs during their worklives and when they withdraw their funds at retirement. Total IRA assets now exceed the money in 401(k)s (see Figure 1).

Figure 1. Private Retirement Assets, Trillions of Dollars, 2012 Q2



*Source:* U.S. Board of Governors of the Federal Reserve System, *Flow of Funds Accounts of the United States* (2012).

The rollover of balances from 401(k)s to IRAs is extraordinary given that participants are typically passive in their interactions with their 401(k) plans. They rarely change their contribution rate or rebalance their portfolios in response to market fluctuations or as they age.<sup>6</sup> Thus, one would think that the force of inertia would lead participants to leave their balances in their 401(k) accounts until they draw them down in retirement. The fact that participants actually take the trouble to move their funds suggests a strong motivating force. Some households may be attracted by the opportunity to obtain a wider menu of investment options or to consolidate their account holdings. But others may be seduced by advertisements from financial service firms urging participants to move their funds out of their "old," "tired" 401(k) plan into a new IRA.<sup>7</sup>

The assumption by participants must be that the firms advertising rollovers are operating in the participants' interest, but, in fact, participants very often are moving from being protected by a fiduciary, low-fee environment into a relatively unprotected and potentially high-fee arena.<sup>8</sup>

# The Current Regulatory Environment and Proposed Changes

Registered representatives of broker-dealers are regulated under the Securities Exchange Act of 1934 through a self-regulatory organization, the Financial Industry Regulatory Authority (FINRA). Broker-dealers must meet a standard of suitability when providing information about financial products; they are not fiduciaries who must act "solely in the interest of" their customers as specified under the Employee Retirement Income Security Act (ERISA), which governs private sector employer-sponsored pension plans. But they do have an obligation to treat their customers fairly, consistent with standards of their profession: their recommendations must be reasonable given their customer's financial situation; they must provide timely and accurate information; they must disclose conflicts of interest; and so forth.9

The DOL proposed changes that would result in broker-dealers being classified as "fiduciaries" under the Internal Revenue Code when providing investment advice for IRAs (see Figure 2 on the next page). As such, they would be subject to IRS prohibited

	Internal Revenue Code (IRS)
ERISA (DOL)	
Fiduciary Provisions: A fiduciary must be prudent and loyal. Must act solely in participants' interest, for the exclusive purpose of paying benefits and defraying reasonable expenses. Must be prudent. Must diversify assets.	Prohibited Transactions Provisions: A fiduciary must not "self-deal." Must not deal with plan assets for own interest or ac- count, or be paid by a third party in connection with transaction involving plan assets.
Sanctions: Personal Liability. Other fiduciaries, participants or DOL can sue fiduciaries for plan losses arising from breach of fiduciary duty.	
	Sanctions: Excise Tax = 15 percent of "amount involved" – increases to 100 percent if not corrected i timely manner.
ERISA Plans	Retail IRAs
Private-sector, employment based plans such as 401(k), defined benefit, and ESOP.	Traditional or Roth. Contributions and rollovers. Also similar arrangements like HSAs.

#### FIGURE 2. FIDUCIARY REQUIREMENTS UNDER ERISA AND INTERNAL REVENUE CODE

*Source:* Authors' illustration.

transaction rules. Specifically, under this anti-selfdealing provision, the proposal would prevent brokerdealers from receiving third-party payments such as 12b-1 fees. The prohibition on 12b-1 fees would apply only to the approximately 20 percent of total mutual fund assets held in IRAs.<sup>10</sup>

Several points are important here, because the industry reaction suggests considerable misunder-standing.

First, the DOL proposals do not change the general standard of conduct required of broker-dealers. They can continue to operate under a suitability standard rather than the "solely in the interest" standard required of ERISA fiduciaries.<sup>11</sup>

Second, substantial confusion appears around the prohibition of commission payments.<sup>12</sup> Here it is useful to distinguish between two types of commissions. The first is transactional commissions that broker-dealers receive for the purchase or sale of stocks, bonds, or mutual funds. The second is ongoing payments from mutual funds. At this point, the DOL proposal prohibits only the ongoing payments from mutual funds.

Third, the mechanism through which the DOL can make this change is the agency's ability to define who is a fiduciary under ERISA and/or the tax code by reason of giving advice.<sup>13</sup> The DOL proposal would sweep more broker-dealers into fiduciary status under the Internal Revenue Code by instituting a new test to determine whether an individual is providing investment advice. One of the provisions under the new definition would define a person as a fiduciary if he performs one of the following activities for a fee: "recommendations as to the advisability of investing in, purchasing, holding or selling securities or other property." This part of the definition would likely cover many broker-dealers involved in advising 401(k) participants who are considering an IRA rollover.

As noted, the 2010 DOL proposal has met with a storm of criticism from the industry. The thrust of the criticism is that a large number of IRAs, especially those with smaller balances, are brokerage accounts. Brokers handling these accounts offer advice in the process of performing transactions, and that advice is often paid for by third-party payments such as 12b-1 fees. According to the industry, eliminating these fees could force brokers to charge directly for their advice in the form of a percent of assets under management. The industry asserts that such a pricing approach would raise costs generally and, by increasing the visibility of the cost of advice, result in less advice being provided for low- and moderate-income IRA holders.

# Assessing the Impact of the DOL Proposal

Two approaches are adopted for estimating the impact of the DOL proposal. The first is a back-of-theenvelope calculation and the second uses an intertemporal optimization model to identify the costs and benefits of the proposed reform. In both cases, the estimated effects of the DOL reform are small and the reform's benefits outweigh its costs.<sup>14</sup>

#### Back-of-the-Envelope

The most important aspect of the proposal is that, with respect to IRA transactions, it would prohibit broker-dealers who give investment advice from receiving payments from mutual funds. These payments are primarily 12b-1 fees, which amount to 25 basis points or less for no-load funds and are paid to the broker-dealer for as long as the customer holds the shares.<sup>15</sup> 12b-1 fees were reported to amount to \$9.5 billion for all mutual funds in 2009, a year when mutual fund assets were roughly the same as today.<sup>16</sup> Assuming that the share of fees attributable to IRA customers is about 20 percent, they should expect to receive rebates of about \$2 billion, or 4 basis points on total IRA assets.<sup>17</sup>

Any additional reduction in fees depends on the extent to which broker-dealers steer customers away from actively-managed mutual funds (93 basis points for equity funds and 66 basis points for bond funds, including 12b-1 fees) and towards index funds (14 basis points) (see Figure 3). If one third of mutual fund assets (including both equity and bond funds) were shifted to low-fee index funds, total IRA fees could fall by another 7 basis points.<sup>18</sup> Additionally, if one believes the estimates that actively-managed equity funds underperform index funds by as much as 224 basis points as reported in Malkiel (2005), then a shift of one third of IRA mutual fund assets to index funds could produce another 13 basis points, but that should be considered a maximum.<sup>19</sup> A reduction in fees between 4 basis points and 24 (4+7+13) basis points would save the consumer between \$2 billion and \$12 billion.

An open question is whether broker-dealers would take actions to offset the loss of the \$2 billion in 12b-1 fees. This \$2 billion loss would amount to about 1 percent of their total (non-trading/non-underwriting)



FIGURE 3. EXPENSE RATIOS OF ACTIVELY-MANAGED AND

Notes: Expense ratios are measured as asset-weighted averages. The figure excludes two types of mutual funds: those available as investment choices in variable annuities and those that invest primarily in other mutual funds. *Source*: Investment Company Institute (2012).

annual revenue (\$200 billion). Broker-dealers could make up the loss in a number of ways: they could increase the price of transactional commissions; raise their volume of transactional commissions by increased buying and selling of securities; or shift to fee-based advisory accounts. It seems unlikely that broker-dealers are going to change what has been viewed as a successful business model for a 1-percent decline in revenues. Thus, the best prediction is that the DOL proposal will reduce fees modestly but will not cause any meaningful disruption in the provision of advice.

#### The Optimization Model

Any reform will likely reduce fees to some extent, thereby improving net returns for investors. With higher net returns, households can save less to achieve any given level of retirement income and will be able to enjoy higher consumption both before and after retirement. The purported risk is that reform may cause broker-dealers to limit the availability of financial advice, resulting in households choosing inappropriate asset allocations, failing to diversify their portfolios, and failing to save enough for retirement. The exercise first considers the potential benefits from reducing fees, measured as the percentage of salary that a household would pay to avoid a high-fee investment. That is, it calculates the percentage of salary that would leave the household indifferent between the optimal portfolio and a higher-fee portfolio. It assumes that households change neither their portfolio allocation nor their saving rate in response to the decline in net returns, so the calculations represent an upper-bound estimate of required compensation.

The model considers three scenarios: 1) 12b-1 fees are eliminated, resulting in an increase in net-of-fee returns of 4 basis points; 2) the returns on activelymanaged stock and bond mutual funds are reduced by fees in excess of those for low-cost index funds; and 3) the returns on actively-managed *equity* funds are reduced by the excess fees and by underperformance relative to the relevant indices as reported in the literature. The calculations assume, based on Malkiel (2005), an upper bound estimate of 224 basis points (including the impact of fees).

The results are reported in Table 1. The first row shows the percentage of salary that a household investing in actively-managed funds that were not subject to 12b-1 fees would pay to avoid the imposition of those fees. The second and third rows show the percentage of salary a household investing in low-cost index funds would pay to avoid investing in funds whose returns are reduced by: 1) the excess fees on actively-managed stock and bond funds; and 2) the typical underperformance of actively-managed funds, part of which is attributable to fees and trading costs. These amounts – 0.3 percent, 6.6 percent and 10.0 percent – closely approximate the percentage impact of higher fees and underperformance on lifetime consumption.<sup>20</sup>

TABLE 1. AMOUNT A HOUSEHOLD WOULD PAY TO AVOIDHIGH-FEE ACCOUNTS, PERCENT OF SALARY

Avoiding	Percent of salary
Only 12b-1 fees	0.3 %
Actively-managed funds	6.6
Actively-managed funds including underperformance	10.0

Note: The calculations assume constant relative risk aversion utility with a coefficient of risk aversion of five. *Source*: Authors' calculations.

The model then considers three types of mistakes that investors might make: 1) choosing an inappropriate asset allocation; 2) failing to diversify the stock component of their portfolios<sup>21</sup> so that, while they enjoy the same expected return, they take on uncompensated risk; and 3) saving too little. Two scenarios are considered. The first, and most likely, is that the reform has no effect on the availability of advice. The second assumes that 50 percent of the households "at risk" forgo advice and then make one of the above investment mistakes. Households "at risk" of forgoing advice most likely constitute only one-third of IRA holders; the other two-thirds have either a relationship with a financial advisor in which they already pay for advice, or a discount brokerage arrangement in which they are currently not receiving any advice.<sup>22</sup>

Table 2 reports the percentages of salary that households would be willing to pay to avoid making the above mistakes, averaged over both those who forgo advice and those whose use of advice is unaffected by the reform.

The calculations in Tables 1 and 2 can then be used to evaluate the net effects of reducing fees. The benefit of eliminating 12b-1 fees is equivalent to 0.3 percent of salary. The cost depends on the percent of households that forgo advice and the severity of the resulting investment mistakes they make. Our best estimate is that a 4-basis-point reduction in fees will have no discernible effect on the supply of financial advice (as reflected in the first column of Table 2).

# Table 2. Amount a Household Would Pay to Avoid Mistakes, Percent of Salary

	Percent of salary	
Mistakes	0% "at risk" forgo advice	50% "at risk" forgo advice
Asset allocation mistakes: extreme stock allocation		
100% at all ages	0.00	0.42
0% at all ages	0.00	0.63
Portfolio allocation mistakes: failure to diversify		
10 stocks	0.00	0.65
4 stocks	0.00	0.77
2 stocks	0.00	0.98
Saving rate mistake		
Saving nothing at all	0.00	1.05

Note: The calculations assume constant relative risk aversion utility with a coefficient of risk aversion of five. *Source*: Authors' calculations. Larger reductions in fees would, of course, bring larger benefits but might also result in some reductions in the supply of financial advice. Nevertheless, in such a scenario, the benefits would still dwarf the costs. For example, as noted in Table 1, shifting households to index funds would substantially increase the benefits from lower fees – to 6 percent or more of salary. On the cost side, even under the extreme assumption<sup>23</sup> that these lower fees result in half of households forgoing advice, the estimates of the individual investment mistakes are all 1 percent of salary or lower (see the second column of Table 2).

# **Bolder** Proposals

Given the potentially modest impact of the DOL proposal, more ambitious reforms to reduce investment fees merit consideration. The policy justification for such reforms is that, given the tax advantages provided to 401(k)s and IRAs, the government needs to ensure that the accounts are managed in the best

interests of participants. High fees frustrate this policy objective. The proposed options fall into four categories: 1) making it easier to retain accu-

mulations within the 401(k) system; 2) making the rollover from a 401(k) to an IRA an ERISA-covered event; 3) extending ERISA to all rollover IRAs; and 4) instituting changes to further control fees in both 401(k)s and IRAs. Some of these changes could be accomplished through rule-making, while others would require legislation.

# Making It Easier to Keep Money in 401(k)s

At a minimum, participants should be encouraged to keep their money in the 401(k) system when switching jobs, rather than rolling balances over into IRAs. Keeping money in 401(k)s has three advantages: 1) 401(k)s are covered by ERISA fiduciary standards, which require financial advisers to act solely in the participant's interests; 2) recent DOL disclosure requirements have helped shine a spotlight on fees; and 3) 401(k)s operate in a wholesale environment, lending them potential pricing advantages in dealing with investment managers.

Two straightforward changes could help here. First, workers switching jobs should always be allowed to keep their 401(k) assets with their previous employer. This proposal would require a change in the provision that allows employers to cash out account balances of less than \$5,000.24 Second, workers should always be allowed to move their 401(k) assets from a previous employer to a new employer. This proposal would require a change in the provision that gives employers the option to deny a rollover from a previous plan.<sup>25</sup> Conversations with experts suggest that employers would not be opposed to retaining accounts or accepting accounts from former employers, because higher balances give them more leverage when negotiating fees. Both changes would increase the likelihood that participants stay in the relatively protected 401(k) environment.

#### Regulating Rollover Transactions

Even with changes to keep money in the 401(k) system, some will want to roll over their balances to

More ambitious reforms to reduce investment fees merit consideration.

IRAs. In this case, it is important that they think carefully before moving their money. One option is to make any rollover transac-

tion subject to ERISA, given that the assets in 401(k)s come from the employer plan arena.<sup>26</sup> Such a change would mean that an adviser could recommend a rollover only when it was solely in the client's interests, as the adviser would be subject to the higher standard required of 401(k) fiduciaries. Participants considering a rollover could also be presented with disclosure forms comparing fees in their 401(k) plan with those in their proposed IRA and showing the respective impacts on projected wealth at retirement. Finally, if a 401(k) participant does decide to go ahead with an IRA rollover, policymakers could set a default investment vehicle of a life-cycle index fund.

#### Extending ERISA to All Rollover IRAs

The most sweeping reform option would be to extend ERISA protections to all rollover IRAs. The rationale is that rollover money has been accumulated in the employer plan arena, which is protected by ERISA's fiduciary standards and fee disclosure, and that the concern for protecting these funds is not lessened by their movement into another form of account. Most likely, if the enactors of ERISA had envisioned that most defined contribution money would end up in IRAs, they would have ensured ERISA-type protections for these accounts. The change might create its own complications, requiring other modifications to ERISA and creating new overlaps in agency jurisdictions.

#### Controlling Fees

The DOL has undertaken a major effort to ensure that employees have access to low-cost funds, but four additional options would greatly improve the fee situation. These options include: establishing benchmarks for 401(k) fees; requiring reporting and benchmarks for IRA fees; requiring 401(k) plans to offer index funds; and eliminating high-cost, actively-managed funds.

First, existing 401(k) fee disclosures could be enhanced if the disclosure form compared the costs of the individual's current investments with those of the typical stock or bond index fund, along with an estimate of the percentage increase in wealth at age 65 from switching to the index fund.<sup>27,28</sup>

Second, providers of IRAs could be required to report on the asset holdings and fees charged in these accounts. This information would make it possible for people considering rolling over their balances to compare their 401(k) fees with those in IRAs.

Third, all 401(k) plans could be required to offer low-cost index funds, including an equity fund, a bond fund, and a life-cycle fund. As part of this proposal, the government could give a "seal of approval" to low-cost funds that meet certain criteria.

Finally, a more ambitious reform is to limit investment options to low-cost index funds for 401(k)s and, if ERISA were extended, for rollover IRAs as well. As discussed earlier, virtually all researchers agree that most actively-managed equity funds can be expected to underperform index funds once fees are considered. It makes no sense to expose the average participant to these options. If people want to buy activelymanaged funds with their non-tax-advantaged saving, that is fine. But in plans that cost the taxpayer money, investing should be cost effective. A variant of such a proposal would leave some room for actively-managed funds with low fees.

In short, a number of options are available for controlling fees beyond those already implemented by the DOL.

# Conclusion

Additional protections are required in the IRA market. As long as accumulations are held in 401(k) plans, participants remain in a world in which sponsors must operate as fiduciaries and fees are under a spotlight. Once they roll over their accounts into IRAs, they enter a world where suitability becomes the standard of care and broker-dealers are paid commissions that encourage the sale of high-priced mutual funds. If a fiduciary standard and attention to fees are appropriate for retirement assets when they are in a 401(k) plan, then such safeguards are clearly still appropriate when they are rolled over. The DOL proposal reflects this logic.

Although the DOL proposal has met with a storm of controversy, it involves a modest change in the form of eliminating 12b-1 and other fees that might incent broker-dealers to misdirect their clients' investments to high-fee products. In the short run, the direct impact of such a change would be rebates to IRA investors of about 4 basis points. Gains could be greater if broker-dealers responded by shifting investments to low-cost index funds. The purported industry concern is that, under the DOL proposal, low- and middle- income households would lose their access to financial advice and make costly mistakes that would reduce their holdings at retirement. Such an outcome seems unlikely for two reasons. First, broker-dealers are unlikely to change their business model in response to a 1-percent reduction in nontrading revenues. Second, even if, in the long run, some IRA holders lost advice as a result of a move to lower-fee funds, such mistakes would have to be both widespread and egregious to offset the gain from lower fees.

Given that the DOL proposals are likely to have only a small impact, it is worth considering bolder approaches to controlling fees. Options include encouraging those with retirement savings to keep it in the 401(k) system, subjecting either rollover transactions or all rollover IRAs to stricter fiduciary standards, and banning high-fee, actively-managed mutual funds from both 401(k)s and IRAs.

In short, the DOL proposal has highlighted an important issue – namely, the enormous growth in rollover IRAs – but it should be viewed as only a modest first step.

## Endnotes

1 The DOL proposal would also extend fiduciary obligations to broker-dealers advising 401(k) participants through self-directed brokerage accounts. But given that only a tiny fraction of 401(k) accounts have a self-directed component, this part of the proposal is not the major source of controversy. In addition, the DOL proposal would have effects on broker-dealers that go beyond fees. For example, it would prohibit selling bonds out of inventory, so called "principal transactions."

2 Munnell, Webb, and Vitagliano (2013).

3 The calculations assume real stock and bond returns of 7 percent and 3 percent respectively, a stock asset allocation of two thirds, 40 years of savings, and real wage growth of 1.1 percent per year. If individuals respond to the decline in projected balances by saving more, the ultimate impact on wealth at retirement will be smaller.

4 For example, see Malkiel (1995, 2005).

5 Bergstresser, Chalmers, and Tufano (2009).

6 Munnell and Sundén (2004); and Ameriks and Zeldes (2001).

7 A Charles Schwab ad shows a man with a 1980s boombox and the tag line "Let's talk about that 401(k) that you picked up back in the '80s." Merrill Edge (launched by Bank of America, owner of Merrill Lynch) depicts a woman with her arms spread and the phrase "Catching up with my old 401(k)s." TDAmeritrade shows a sad young woman with writing in the background that says "roll over your old 401(k)." Fidelity's "follow the green line" campaign includes an ad with a woman speaking to a Fidelity representative about how to roll over her "old 401(k)."

8 This situation generally holds for 401(k) participants at large firms. 401(k) participants at small firms sometimes face higher fees, in which case they may be able to reduce expenses by rolling over 401(k) assets to an IRA.

9 Wrona (2012) argues that interpretations of the suitability standard and other FINRA rules impose detailed and rigorous standards of conduct on broker-dealers.

10 In 2011, total mutual fund assets amounted to \$11.6 trillion, and mutual funds in IRAs amounted to \$2.2 trillion (Investment Company Institute 2012).

11 Thus, studies showing the additional hours required to satisfy the higher standard (for example, Oliver Wyman 2011) appear to be in error, since the standard of conduct would not change.

12 See, for example, American Benefits Council (2011); Insured Retirement Institute (2011); and Investment Company Institute (2011).

13 ERISA gives DOL authority to define "fiduciary" for ERISA purposes. This authority was extended to IRAs under a subsequent reorganization plan that divided up responsibilities (Office of the President of the United States 1978).

14 For more details on the methodology, see the full paper (Munnell, Webb, and Vitagliano 2013).

15 12b-1 fees are explicitly limited to 25 basis points or less for funds identifying themselves as "no-load" funds. This restriction does not apply to load funds, whose 12b-1 fees are capped at 100 basis points. For further details, see Investment Company Institute (2004).

16 Schapiro (2010).

17 Total IRA assets amount to \$5,126 billion, so IRA 12b-1 fees of \$2 billion amount to about 0.04 percent of assets, or 4 basis points. Most likely, mutual fund companies will continue to make the 12b-1 payments because IRAs are only a small portion of the mutual fund market, in which case the broker-dealer will be required to rebate the payment to the customer. If nothing else changes, customers will see their fees decline by the amount of the 12b-1 fees.

18 The 7-basis point estimate is derived as follows. The first step is to estimate the percentage of mutual funds levying 12b-1 fees. If these fees average 25 basis points, and 45 percent of IRA assets is invested in mutual funds (as reported in Investment Company Institute 2012), an estimate of \$2 billion of IRA 12b-1 fees is consistent with one-third of IRA mutual funds levying such fees. Using data from the Investment Company Institute (2012), we then assume that fees are reduced on one third of the 45 percent of IRA assets invested in mutual funds. We further assume that 64 percent of such assets are invested in stock funds, and the remaining 36 percent in bond funds, and that fees on stock funds decline from 93 to 14 basis points, and fees on bond funds from 66 to 13 basis points. The final step is to subtract the assumed saving in 12b-1 fees.

19 The 13 basis points equals additional underperformance of 224 minus 93 basis points, multiplied by the 45 percent of IRA assets invested in mutual funds, the 64 percent of IRA mutual funds invested in stocks, and the one third that is assumed to switch from underperforming actively-managed funds to index funds. The calculations further assume that bond mutual funds do not underperform relevant indices, after accounting for fees.

20 The calculations assume that households face the higher fees during both the accumulation and draw-down phases.

21 Estimates of the standard deviations of undiversified portfolios are taken from Statman (1987).

22 Authors' calculations based on Oliver Wyman (2011).

23 This assumption is extreme because it requires implausible assumptions about the price elasticity of the supply of financial advice.

24 IRS Code 411(a)11 and ERISA 203(e).

25 IRS Regulation 1.401(a)(31)-1, A-13.

26 The DOL might be able to accomplish this change by regulation. If legislation is required, it would involve amending ERISA Title 1, Section 4(a) to include coverage of rollover IRAs. 27 The current fee disclosure requirements have only been in place a short time, so it is not possible to fully gauge their effects. One recent survey (Plan Sponsor Council of America 2012) reported that the requirements have so far had little direct effect. However, anecdotal evidence suggests that some fund providers have already begun to introduce lower fee versions of some of their funds. And the impact of the requirements could increase over time as participants and plan sponsors have more exposure to the new disclosure data.

28 Small 401(k) plans are more expensive to administer, a concern that could be addressed through an appropriate disclosure on the fee statement.

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#### About the Center

The Center for Retirement Research at Boston College was established in 1998 through a grant from the Social Security Administration. The Center's mission is to produce first-class research and educational tools and forge a strong link between the academic community and decision-makers in the public and private sectors around an issue of critical importance to the nation's future. To achieve this mission, the Center sponsors a wide variety of research projects, transmits new findings to a broad audience, trains new scholars, and broadens access to valuable data sources. Since its inception, the Center has established a reputation as an authoritative source of information on all major aspects of the retirement income debate.

#### Affiliated Institutions

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