

401(k) Participants Hold Lower-Cost Funds, September 2007

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New ICI Research Suggests Employers and Workers Are Sensitive to Fees

Washington, DC, September 25, 2007 - Employers and workers in 401(k) retirement savings plans tend to select lower-cost mutual funds with below-average turnover, according to research released today by the Investment Company Institute.

The research paper, [The Economics of Providing 401\(k\) Plans: Services, Fees, and Expenses, 2006](#) sheds light on the fees paid through mutual funds held in 401(k) plans. About half of the \$2.7 trillion in 401(k) assets at year-end 2006 was invested in mutual funds; the bulk of those assets were in stock funds.

The paper shows that 401(k) investors in stock funds paid an average expense ratio of 0.74 percent in 2006, well below the industrywide asset-weighted average expense ratio of 0.88 percent. In fact, more than three-quarters of stock fund assets held in 401(k) plans were concentrated in funds that charged less than 1 percent. Workers invested in bond and hybrid funds also paid below-average expenses. For many mutual fund assets in 401(k) plans, the expense ratio covers a wide range of fees for plan administration and participant services, as well as the cost of investment management.

"401(k) plans provide millions of American workers with the opportunity to invest for their retirement in a cost-effective manner through mutual funds," said Sarah Holden, Senior Director of Retirement and Investor Research and co-author of the report. She cited a number of factors for the relatively low expense ratios of funds held in 401(k) plans, including:

- Competition among mutual funds and other investment products to offer shareholders services and performance;
- Cost-conscious decision-making by employers who select the investment line-up for their 401(k) plans;
- Employers' decisions to cover a portion of plan costs, and,
- Economies of scale in larger 401(k) plans.

"401(k) plans are a complex benefit to maintain and administer," said ICI Assistant Counsel Michael Hadley, co-author of the report. "Today's research attempts to explain the many services 401(k) plans require and the factors that affect their cost."

This complexity makes fee comparisons across individual plans difficult, Hadley said. "All these factors must be considered when evaluating whether a given plan's costs are reasonable."

The research notes that a 401(k) plan's operation is governed by an array of rules, including regulations by the Department of Labor and the Internal Revenue Service and, in the case of mutual funds, securities laws. Administrative services—such as recordkeeping, transaction processing and trustee services—are typically handled by outside service providers.

Because many of these services are common to all plans, the size of the plan and the average account size become key factors that determine overall cost relative to invested assets. "A new plan with few assets probably will be more expensive to maintain than an established plan with more assets and a larger average account size because a large plan can spread the relatively fixed costs of running a 401(k) plan across a larger pool of assets," Holden observed.

For more than a decade, ICI has conducted comprehensive research on fees charged by mutual funds. Comparable information is not readily available for fees charged by other investment options offered in 401(k) plans, such as bank collective trusts and insurance products. The latest study is the second in an annual series examining the services provided by 401(k) plans and the fees that mutual funds charge in such plans.

"This study is more evidence of what financial planners will tell you—if you have a 401(k) plan at work, it is likely the best place to save for retirement," Hadley said.

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