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Facts and Common Sense Undercut Distorted Demos View of 401(k)s

By Brian Reid

By [many measures](#), the 401(k) system has been a tremendous success, helping millions of American workers prepare for retirement. [At the end of last year](#), Americans held \$4.5 trillion in all employer-based defined contribution retirement plans, of which \$3.1 trillion was held in 401(k) plans.

A [new report](#) from Demos—an advocacy group calling for a “new retirement system”—paints quite a different portrait of the 401(k) system, framing it as “inherently broken,” “inefficient,” and marked by “hidden and excessive costs.”

Facts and common sense, however, undercut this report’s arguments and misleading characterizations of the 401(k) system. Let’s review a few key points.

All retirement systems have fees and expenses, and the 401(k) approach to expenses compares well relative to other systems

One troubling aspect of the report is its comparison of a 401(k) balance with fees included and an “ideal” 401(k) balance with “no fees” (see Figure 8 on page 12 of the report). The fact is that all retirement savings systems—defined contribution, defined benefit pension, or hybrid approaches—involve fees and expenses. To suggest that a no-cost system exists or could exist is irresponsible.

Fees pay for essential and valuable services

A [blog post](#) from Demos on the report derides “all those pesky fund brochures and indecipherable financial statements that your 401(k) provider constantly sends to you.” There is nothing “pesky” about providing information and education to investors.

Fees go to cover custodial, legal, transfer agent, and recordkeeping services. These services are critical components in the operation of retirement plans and of a fund structure that offers a unique set of protections to investors. You can read more about those protections with respect to mutual funds in the [appendix of our *Investment Company Fact Book*](#).

The evidence is overwhelming that the 401(k) system is marked by intense competition

The 401(k) market is highly competitive. First, there are many types of firms that provide services to 401(k) plans, including mutual fund companies, banks, and insurance companies, with mutual funds managing about half of the assets. Second, a great many new services have been introduced in the 401(k) market in the past two decades. Third, shareholders and plan sponsors have proven themselves very sensitive to costs. [According to ICI research](#), 401(k) investors in mutual funds tend to hold lower-cost funds with below-average portfolio turnover.

The report’s estimate of the average lifetime fees paid by 401(k) participants is significantly overstated

The eye-catching numbers touted in the Demos report are implausible. First, taking the Demos report at its face value, it implies that stock funds used in 401(k) plans underperform a market basket of stocks by nearly 2 percent a year and bond funds underperform a market basket of bonds by 1.2 percent a year. These wide margins of underperformance are inconsistent with [other studies](#) of funds used in 401(k) plans. Second, Deloitte and ICI conducted a study to determine the [average annual fees for 401\(k\) plans in 2011](#). Totaling all administrative, recordkeeping, and investment fees, the median participant-weighted “all-in” fee for plans was 0.78 percent or approximately \$248 for the year per participant.

The fund industry has a history of supporting transparency in defined contribution plans

Finally, we are disappointed by the report’s strong suggestion that mutual funds are inclined to hide information from investors. To the contrary, the fund industry has a long track record of supporting measures to produce transparency, including the recently issued Department of Labor [final regulations concerning 401\(k\) disclosures](#). Indeed, the Demos report relies extensively on data that the fund industry provides.

You can find more 401(k) information and perspective at our [401\(k\) Resource Center](#).

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