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On behalf of Barclays Global Investors (BGI), I appreciate the opportunity to testify today regarding the *"401(k) Fair Disclosure for Retirement Security Act of 2009"*.

Clearly the events of 2008 were painful for all those investing for retirement: global equities fell over 40 percent, and the average 401(k) investor lost approximately 28% of their accumulated balances. These events have some questioning whether defined contribution (DC) plans can achieve their objective of providing security in retirement for the workers who contribute to them. Yet, for all the talk of the failures of the system, a closer look at the evolution of 401(k) and similar plans reveals significant progress over the last several years. First, the Pension Protection Act of 2006 included a number of provisions to increase employee participation, and we have seen an increasing number of employers using these tools. Second, recent surveys show that despite the equity market events of the past year, the vast majority of DC plan participants are sticking with their plans, leaving their money in and continuing to contribute-evidence that participants understand and value the benefit provided by their DC plan.

However, the impact of the market turmoil on participant balances has added urgency to the debate on what is the optimal design for defined contribution plans, and how should they be structured to allow these vehicles to achieve their long-term objective of retirement security for millions of Americans. Providing plan fiduciaries and individual plan participants with additional targeted information about fees and expenses, which the bill under discussion today will do, will promote better investment decisions and help 401(k) plans to better deliver retirement security for American workers.

Background on BGI

BGI [1] was founded in 1971 as part of Wells Fargo Bank in San Francisco, California. Today, we are owned by Barclays PLC, one of the world's leading diversified financial services companies. We are headquartered in San Francisco with approximately 1600 employees in California and elsewhere in the U.S. and another 1400 worldwide serving the needs of our global clients. BGI is one of the world's largest institutional asset managers, and is the largest provider of structured investment strategies, such as index, tactical asset allocation and quantitative active strategies. BGI pioneered the first institutional index fund strategy in 1971, and has continued a tradition of financial innovation ever since—including the development of target date retirement (lifecycle) funds in the early 1990's

Overview

BGI is pleased to see the focus of this Committee, the Department of Labor and others on the ways in which services are provided to employee benefit plans and in the way service providers are compensated. Increased complexity has made it more difficult for plan sponsors and other plan fiduciaries to understand what the plan actually pays for specific services and where the potential exists for conflicts. This is particularly so for DC plans, where over the last decade the costs associated with managing and maintaining the plan have increasingly been shifted to plan participants--often through bundled fee arrangements where administration and investment management are offered by the same provider.

Managers of defined benefit (DB) pension plans have well-established tools that allow for savings and investment today in order to deliver retirement benefits for workers far in the future. Using a fully funded DB plan for comparison, we identify four dimensions of comparability for DC plans—contributions, investment quality, portability and lifetime income. Most of our testimony will focus on the second of these—investment quality--which necessarily includes the one of the largest determinating factor in long-term performance— which is fees and expenses.

[1] BGI includes Barclays Global Investors, N.A. and its worldwide asset management affiliates.

First, let me briefly address the other dimensions. In a DB plan, contributions are mandated as function of funded status. In a DC plan, it is the participant who must decide if they want to participate, and how much they want to contribute. The Pension Protection Act of 2006—part of the progress in DC plans referenced above—provided plan sponsors with fiduciary protections in establishing auto-enrollment and auto-default savings rates. Data shows plans are adopting auto-enrollment, with the number almost doubling from 2005. And, of the top 1000 plans in the United States, over 53 percent now offer auto-enrollment for new employees.[2]

Studies have also shown that people tend to accept the terms of auto-enrollment as given. They are unlikely to opt out, and they are also likely to stay with the default savings rates—now generally set at 3 percent.[3] So inertia is working but it could work even better. Early results from researchers in the behavioral finance field indicate that even if you take the default savings rate up to 6, 7, 8 or 9 percent, you won't see a meaningful number of participants opting out. So, although we don't have the level of funding that's required to support retirement adequacy today, we can get there by encouraging more and more plan sponsors to automatically enroll participants and by creating further incentives for employers to increase the default saving rate to 6 percent and higher.

Another dimension of pension investing is portability, arguably the one area where DC plans outpace DB plans. Unlike the traditional DB plan where unvested balances are typically lost when an employee leaves, the DC plan system explicitedly recognizes the more transient nature of today's worker, where contributions actually follow an employee. The DC portability feature is not without its flaws. Moving balances from one employer to the next is difficult and requires a participant to take action. And we know that if exiting employees take a cash distribution, a significant amount of those funds leak out of the retirement system.

Another comparable to DB plans is lifetime income. Every DB plan offers the opportunity for participants to choose income for life. But this critical component has

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[2] Hewitt Associates "Trends and Experience in 401(k) Plans 2007".
[3] The Importance of Default Options for Retirement Saving Outcomes: Evidence from the United States. Beshears, Choi, Laibson, Madrian (2007).

yet to have been addressed in a meaningful way in the 401(k) system today. Important as it is to accumulate sufficient assets during a participants working years, it is also as important to have a strategy to fund consumption in retirement. Many financial services providers, including BGI, are engaged in designing products for the DC market to manage the twin risks of inflation and longevity. These products take two principal forms: guaranteed minimum payments for set periods and annuities. The market turmoil in 2008 has increased the interest of both plan sponsors and plan participants in these products.

Now, moving closer to the subject of today's hearing, is the dimension of investment quality. DB plans tend to be well diversified, use institutional-quality managers and rebalance on a regular basis back to a strategic asset allocation. To mimic this in a 401(k) world, ideally the majority of plan participants would be invested in auto-rebalancing strategies that are constructed with institutional quality funds. Clearly these allocations would need to be age appropriate, provide acceptable outcomes across a range of different market environments, and be priced at levels that reflect the bulk buying power of 401(k) plan sponsors.

More DC plans today offer pre-mixed portfolios that are well diversified and auto-rebalancing than ever before.[4] And again, the PPA has moved things in the right direction, by providing a level of fiduciary relief for plan sponsors to default participants into just these types of investments. Congress should also consider changes that would allow employers to diversify participants out of heavy concentrations of company stock as they near retirement.

The legislation under discussion today addresses two of the largest issues for DC plans: first, for *plan sponsors* to have sufficient information about fees and expenses to discharge their fiduciary responsibilities in the selection of service providers.
And second, the need for *plan participants* to have ready access to appropriate, easily understood information about critical issues that affect their investment decisions.

Elements of a Disclosure Regime for Plan Sponsors

[4] Cerruli, Retirement Markets 2007; Hewitt Associates "Trends and Experience in 401(k) Plans 2007.

We believe the appropriate elements of a disclosure regime for plan sponsors must rest on the unique fiduciary considerations that a plan sponsor encounters in establishing designated investment alternatives under a DC plan and in choosing investment funds for the plans. Due to the importance and significant cost of providing plan participant level administration and recordkeeping, a plan sponsor must determine how best to provide and pay for these services. Recordkeeping expense is often—but need not be—funded on a "bundled" basis through the expenses charged against assets held by the investment funds in which the plan invests and/or through fees received by the investment manager. In addition, it is more often the case that plan participants fund all the major costs of the plan (administration, recordkeeping and investment management). Plan sponsors are thus often in the position of agreeing to the fees and expenses that participants will fund through direct or indirect deductions from their investment balances in the plan. As such, we believe it is important that plan sponsors receive sufficient information, in sufficient detail, to appropriately discharge this responsibility.

Today, the information the plan sponsor needs is sometimes difficult to obtain or difficult to compare. There are two reasons for this. First, the myriad investment alternatives (mutual funds, insurance products, bank collective trusts, separately managed accounts) have differing compensation mechanisms and differing terminology for what may be the same service. Second, it can be more difficult to evaluate fees and expenses when fees for investment management are bundled with fees for administrative, recordkeeping and related services.

It is not enough for plan sponsors and other plan fiduciaries to understand what fees and expenses are explicitly deducted from a participant's account or paid directly from plan assets or by the plan sponsor from its own funds. To fully evaluate potential investment options and service providers, and their appropriateness for its plan, plan sponsors must understand fully how each service provider is compensated, both directly and indirectly[5]. BGI supports legislative efforts to require service

[5] The Department of Labor proposed service provider exemption under Section 408(b) (2) [citation] also seeks to provide plan sponsors with information necessary for the sponsor to determine that a contract or arrangement is reasonable. (See, *Reasonable Contract or Arrangement Under Section 408(b)(2)—Fee Disclosure* 72 FR 70988). However, as proposed, service providers offering a bundle of services generally are not required to break down the aggregate compensation or fees among the

providers to provide specific disclosures, by fee category, so as to make plan sponsors' decision-making less burdensome.

A worthwhile disclosure regime permits a comparison of "like with like". The challenges faced by plan fiduciaries in making decisions among service providers for the same services is compounded by the inability to make comparisons. For example, a plan sponsor who is evaluating a proposal from (a) a bundled provider who offers a full range of affiliated investment options, (b) a proposal from an independent recordkeeper whose platform can accommodate most any investment option available in the DC market, and (c) a proposal from a bundled provider who permits the plan fiduciary to add unaffiliated investment options but is generally priced for a plan using affiliated investment options, will find it difficult to make effective comparison of relative costs. In the first proposal, the sponsor cannot determine the fee for plan level administration/recordkeeping, in the second the cost of administration and investment are separate and thus transparent, and in the third, the mix of investment options drives the overall cost to the plan and its participants but without knowledge of the underlying fees in administration/recordkeeping, the plan fiduciary may be unable to determine if any particular affiliated investment option is appropriately priced.

Bundled service arrangements may be appropriate for some plans, particularly smaller ones[6]. This is only appropriate if the fee components of both recordkeeping and asset management are separately and clearly disclosed. Clear, comparable and fully disclosed information about compensation will allow the plan sponsor to more easily and adequately meet its fiduciary responsibility under ERISA to determine that the fees and expenses are reasonable.

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individual services comprising the bundle, with two exceptions—if separate fees are charged against a plan's investment and reflected in the net asset value, and if compensation or fees are set on a transaction basis (even if paid from mutual fund management or similar fees). Further, we note that the mutual fund industry has questioned whether the Department's proposed regulation can require investment advisors to mutual funds to make disclosures to plan fiduciaries as contemplated under the proposal—even though these investment managers receive the major portion of plan fees if the plan sponsor chooses mutual funds as the designated investment alternative. See, Testimony of Paul Schott Stevens, President and CEO, Investment Company Institute, Department of Labor Hearing on 408(b)(2) Proposal (April 1, 2008). The legislation under discussion today addresses these deficiencies.

[6] Bundled services may provide the lowest cost alternative for small plans. It is not the bundling of services together that is of concern, but rather the plan fiduciary's need to be able to compare the costs of certain services as between potential service providers and in myriad configurations.

It is worth noting that in our experience in the defined benefit market, asset management services and administrative services, such as trustee services, are generally disclosed separately. This transparency has contributed to the salutary effect of bringing both the investment management fees and administration costs down over the last decade.

Elements of a Disclosure Regime for Plan Participants

The appropriate elements for a disclosure regime for plan participants must be grounded in an understanding of the two levels of investment decision being made in DC plans. The first, made by plan fiduciaries, is to decide what investment choices to make available to plan participants from the enormous array of potential investments and the second, the decision by plan participants regarding how to direct their funds among the options selected by the plan sponsor. The information necessary for a plan fiduciary to determine what investment options to offer (and which service providers to retain) differs from the information which plan participants need when choosing an appropriate investment from amongst those investment options.

The most fundamental decisions that plan participants need to make are whether, and at what level, to participate in the plan; which investment options to choose; and whether and when to change their investment allocations. These decisions are critical to the future value of the account. Participants' decision making is influenced by many considerations including basic behavioral finance factors.

BGI believes that participants need information communicated in a way that is easy to understand and facilitates comparison across the full range of designated investment alternatives, including automated asset allocation funds (i.e., target date funds and managed accounts). Funds should be organized around risk level, rather than by asset class, as participants do not necessarily understand asset class designations, but do understand risk levels such as "conservative", "moderate", "moderate aggressive" and "aggressive". There should be a separate section called "premixed asset allocation products" for multi-asset class investments and indicate the the risk level is either static or a function of the investment horizon. This approach provides two benefits: it provides basic risk information without the necessity for a plan participant to review

another document and eliminates the category of "other" which otherwise would include all designated investment alternatives that are not stock or bond funds.[7]

A fund description should be provided that communicates the investment objective succinctly and in 'plain English'. We don't believe the mere identification of the management style of the fund as being 'passive' or 'active' provides useful information to most participants, who would not be familiar with this terminology. We note that unless asset based fees for administration/recordkeeping are disaggregated from management fees, the distinction between passive and active is not very meaningful—participants need to understand how much excess return ('alpha') they should be expecting vis-à-vis the fee to be paid. If certain investment options carry more administrative/recordkeeping fees than others (which is not uncommon), plan participants need to understand that higher fees are not necessarily due to high excess return expectations.

Behavioral finance research shows that when confronted with too much information, or information that is not organized to be customer friendly, participants fail to participate or engage in decisions about their investment allocation. While transparency as to fees and expenses is important for plan participants, any disclosure document also needs to present this information in context, as too much focus on fees and expenses could promote a tendency among participants to opt for the lowest cost option, (most likely to be a money market fund or company stock) to the detriment of their retirement income. Failure to adequately diversify investments is one of the more common errors made by plan participants.

A number of plans provide multiple investment options within the same general strategy (for example, several large cap domestic equity funds). When a plan does so, behavioral finance research suggests that plan participants would also benefit if the alternatives within the same strategy were either ranked by cost or the least cost alternative were highlighted in someway.

Other

[7] Company stock, an investment option in a number of DC plans, will need to be addressed separately due to the particular nature of this investment option as compared to other investment strategies.

The bill also proposes that all DC plans provide an investment option that is an unmanaged or passively managed fund meeting certain criteria as to its securities portfolio and investment objectives (including the likelihood of meeting retirement income needs if funded at adequate levels. We believe one of the advantages of ERISA is that it permits plan sponsors and plan fiduciaries to make their own prudent decisions about what investments are appropriate for their plan participants and beneficiaries. However, the Committee may wish to consider the approach taken by the Federal Employee Retirement Security Act of 1986 (FERSA) which established the Federal Thrift Savings Plan. As amended, FERSA includes six categories of investment options, with a focus on index strategies across the investment spectrum (equity and fixed income) as well as lifecycle funds. While many plan sponsors do provide passive investment options in their plans, this Committee should consider how to further encourage this trend.

Conclusion

Achieving financial security in retirement is a significant challenge for most Americans. Currently, many DC plans have challenges with three of the four major dimensions of retirement security: the contribution, or savings, component; the investment quality component; and the retirement distribution component. By promoting more effective disclosure of fees and expenses to plan sponsors and plan participants, the *401(k) Fair Disclosure for Retirement Security Act of 2009* would improve the second component. Increased transparency can be an important catalyst for making DC plans performs more like DB plans in the balance of costs and investment performance and thereby improving the future income of all retirees.

Additional Background on BGI

At December 31, 2008, BGI managed over $1.5 trillion, of which approximately $200 billion represents defined contribution plan assets. For both its defined contribution and defined benefit plan clients, BGI acts solely as an investment manager. Neither BGI nor any of its affiliates currently act as master trustee or provide recordkeeping services. It does act as a collective fund trustee and as a named custodian with custody operations, fund accounting and related services provided by third parties.

Since its founding, BGI has remained true to a single global investment philosophy, which we call *Total Performance Management.* BGI manages *performance* through the core disciplines of *risk, return,* and *cost* management. The success of our indexing methodology results from our focus on delivering superior investment returns over time while minimizing trading and other implementation costs and rigorously controlling investment and operational risks. It has been the foundation for the way we've managed money for over 30 years and we believed it has served our clients very well.

BGI's clients are "institutional", by which we mean defined benefit and defined contribution pension plans sponsored by corporations or public agencies, and endowments, foundations and other similar pools of capital. BGI's services to its clients are completely focused on investment management; we do not provide other services, such as recordkeeping. Among those institutions we have been honored to serve is the Federal Thrift Savings Plan (TSP). BGI was first appointed a manager for the TSP in 1988, and we have successfully retained and grown this relationship in regular, highly competitive bidding processes since that time.