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Highlights

Highlights of GAO-11-119, a report to the Ranking Member, Committee on Education and the Workforce, House of Representatives

January 2011

401(K) PLANS

Improved Regulation Could Better Protect Participants from Conflicts of Interest

Why GAO Did This Study

Recent volatility in financial markets highlights the need for prudent investment decisions if 401(k) plans are to provide an adequate source of retirement income. While plan sponsors and participants may receive help in assessing their investment choices, concerns have been raised about the impartiality of the advice provided. GAO was asked to describe circumstances where service providers may have conflicts of interest in providing assistance related to the selection of investment options for (1) plan sponsors and (2) plan participants, and (3) steps the Department of Labor (Labor) has taken to address conflicts of interest related to the selection of investment options.

What GAO Recommends

GAO recommends that Labor amend pending regulations to require that service providers disclose compensation and fiduciary status in a consistent, summary format and revise current standards, which permit a service provider to highlight investment options in which it has a financial interest. GAO also recommends that the Department of the Treasury amend proposed regulations to require disclosure that investment products outside a plan typically have higher fees than products available within a plan. Overall, Labor and Treasury generally agreed to consider our recommendations as they evaluate comments received on pending regulations.

View GAO-11-119 or key components.
For more information, contact Charlie Jeszeck at (202) 512-7215 or jeszeckc@gao.gov.

What GAO Found

The sponsors of 401(k) plans face conflicts of interest from service providers assisting in the selection of investment options because of third-party payments and other business arrangements. For example, providers who help sponsors to establish and maintain their plans may receive third-party payments from investment fund companies. The payments, sometimes called revenue sharing, create a conflict of interest because the provider may receive greater compensation from certain funds. Moreover, providers are reported to commonly structure their relationships with sponsors in a manner that avoids being subject to fiduciary standards under the Employee Retirement Income Security Act (ERISA). According to several industry experts, many sponsors, particularly of smaller plans, do not understand whether or not providers to the plan are fiduciaries, nor are they aware that the provider's compensation may vary based on the investment options selected. Such conflicts could lead to higher costs for the plan, which are typically borne by participants.

In certain situations, participants face conflicts of interest from providers that have a financial interest when providing investment assistance. For example, although investment education is defined as generalized investment information, providers may highlight their own funds as examples of investments available within asset classes even though they may have a financial interest in the funds. According to industry experts, participants perceive education as investment advice. Thus, participants may not understand that the provider is not a fiduciary adviser required to act solely in participants' best interests. Also, several industry experts expressed concerns that providers stand to gain higher profits from marketing investment products outside of plans to participants, a practice known as cross-selling. For example, if participants use their plan provider for Individual Retirement Account rollovers, they may not understand, because of insufficient disclosures, that fees are often higher for products offered outside the plan and that the provider may not be serving as a fiduciary adviser. Consequently, participants may choose funds that do not meet their needs and pay higher fees, which reduce their retirement savings.

While Labor has taken steps to address the potential for conflicted investment advice provided to sponsors and participants, more can be done to ensure they receive impartial advice. In fiscal year 2007, the Employee Benefits Security Administration (EBSA) began a national enforcement project that focuses on the receipt of improper or undisclosed compensation by certain providers, but its enforcement efforts are constrained to fiduciary providers and limited by EBSA's approach for generating cases. In addition, EBSA issued regulations to revise the definition of an ERISA fiduciary and require enhanced disclosure of providers' compensation and fiduciary status. These regulations, as currently specified, would help EBSA and sponsors detect and deter conflicted investment advice. However, the regulations do not require that certain disclosures be made in consistent or summary formats, which may leave sponsors with information that is not sufficient or comparable.