Discussion of

"Mutual Fund Revenue Sharing in 401(k) Plans"

Veronika Pool
Clemens Sialm
Irina Stefanescu

WFA 2021

Jonathan Reuter
Boston College & NBER

What Does Paper Do?

- Analyzes hand-collected data on indirect compensation within 401(k) plans, **2009-2013**
- Finds “revenue sharing” distorts investment menus (less likely to drop/more likely to add), increasing participant fees and recordkeeper revenues
- *Important research topic given role 401(k) plans play in U.S. retirement saving*
- *Fact that data on revenue sharing historically hard to collect highlights potential concern*

Three Comments

- Fee differences may be overstated
  - Plans that use revenue sharing may have explicit goal of having participants cover plan costs
  - Fund-level analysis likely ignores revenue credits to participants
  - Would never expect revenue sharing funds to earn higher after-fee returns
- Ideally, should test whether fee differences decline following 2012 change in disclosures
- Framing: Belongs to literature linking changes in commissions to changes in fund competition

Institutional Details

- Findings that reliance on indirect compensation for advice leads retail investors to lower-quality segment of MF market...
  - Bergstresser et al. (RFS 2009), Christoffersen et al. (JF 2013), Del Guercio and Reuter (JF 2014)
- ... may not generalize to 401(k) plans
  - **Plan sponsors are fiduciaries that are expected to follow a process for adding/removing funds**
  - **Large plans have ready access to consultants**
  - **Since at least 2010, plan sponsors receive revenue sharing credits from recordkeepers**

1. Fee Differences Overstated?

- Sponsors are not required to pay all plan costs
- Sponsors may opt for revenue sharing to shift plan costs to participants (vs. all employees)
  - Sponsor will want to retain revenue sharing funds, which charge higher fee to allow for revenue sharing
  - Participants will pay higher all-in fees by design
- If this is the case, counterfactual should not be a plan that pays all costs for participants
  - Switching to institutional share classes will reduce participant fees by shifting costs back to sponsor

Revenue Credits Increasingly Common

- % plans answering "Yes, there is a fee credit and we use it" growing during sample period
  - **2010** **20%**
  - **2011** **20%**
  - **2012** **28%**
  - **2013-14** **32%**
  - **2015** **39%**
- *Source: Deloitte's 401(k) benchmark survey, '12 & '15*
- Only the 54% of plans in authors' sample with revenue sharing are eligible for a fee credit

How are Fee Credits Used?

Exhibit 6.8. How do you use the fee credit resulting from revenue share?

	2013-2014	2015
Fee credits are used to purchase additional services from our provider, such as communication materials, investment advice tools, etc.	7%	8%
Fee credits are used to pay for other plan expenses, such as plan audit fees, consultant fees, etc.	76%	66%
Fee credits are used to allocate the credit back to participants (Pro rata based on account balances)	17%	24%
Fee credits are used to allocate the credit back to participants (Equal dollar amount to all participants)	0%	2%

n=110

- *Source: Deloitte's 401(k) benchmark survey, '15*

Do Authors Observe Fee Credits?

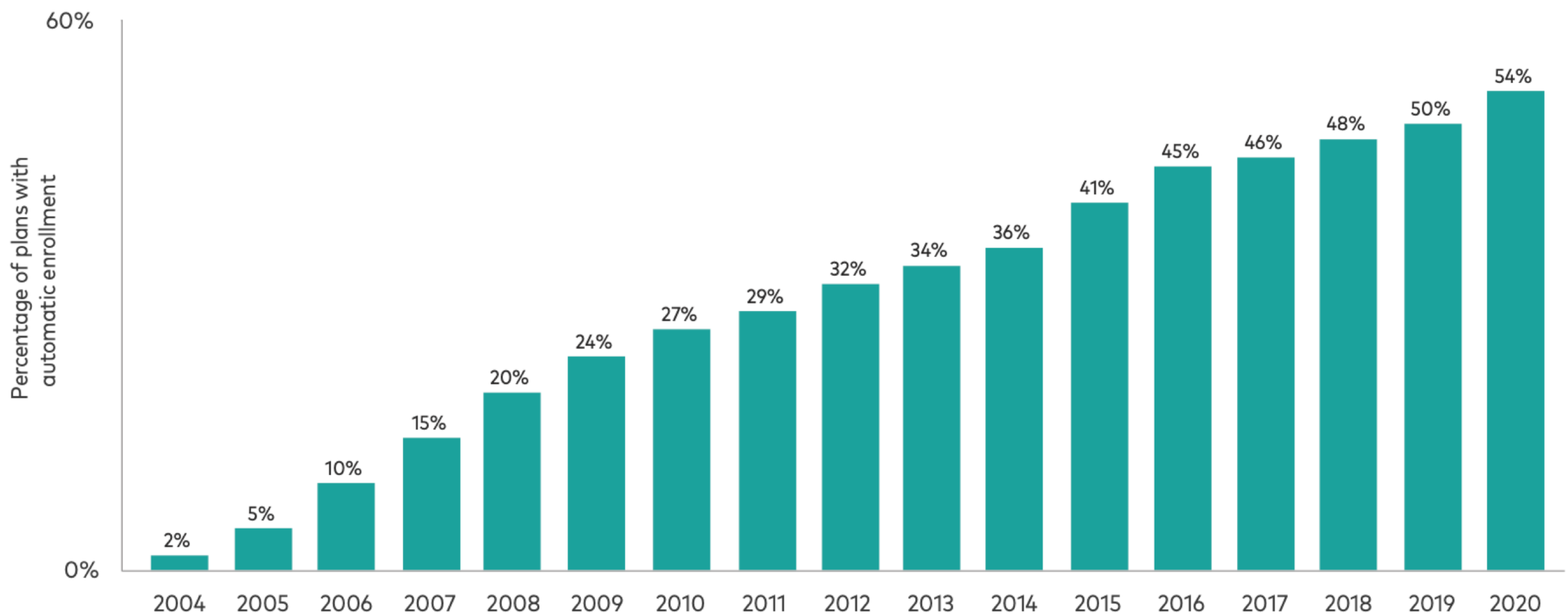
- Revenue sharing neither good nor bad, *per se*
- Participants should be indifferent between:
  - Paying 25 bp in revenue sharing or a 25 bp account fee... *both of which the authors should observe*
  - Paying 25 bp in revenue sharing and receiving a 25 bp fee credit... *which the authors may not observe*
- Because those investing in higher revenue-sharing funds will pay relatively more in revenue sharing ➜ it would be good to know more about revenue sharing in default investment options

Revenue Sharing and Auto-Enrollment?

- **Flip side:** Plans may adopt revenue sharing when they adopt auto-enrollment to offset any costs associated with rolling plan out to younger, lower-salary participants

Figure 16. Automatic enrollment adoption

Vanguard defined contribution plans with employee-elective contributions



Source: Vanguard 2021.

2. Changes in Regulation

Several important changes in regulation during sample period

- **2009:** DOL requires disclosure of fund-level revenue sharing data ➜ *data used in this paper*

- **2010:** Regulated Investment Company Modernization Act of 2010, H.R. 4337 allows funds to rebate revenue sharing to plan sponsor/participants ➜ *fee differences likely overstate participant cost differences*

- **2012:** DOL rule 408(b) requires “providers to disclose a transparent estimate of their fees to plan sponsors” ➜ *(another) opportunity to test for impact of disclosure*

2. Changes in Disclosure *(cont.)*

- Under **null hypothesis** that plan sponsors understand how revenue sharing works, there should be no changes in the all-in participant costs at revenue-sharing plans following the 2012 change in disclosures
- Under **alternative hypothesis** that increased disclosure highlights and reduces conflicts of interest between sponsors and recordkeepers, all-in participant costs (and total plan costs paid by sponsors and participants) should fall

2. Changes in Disclosure *(cont.)*

- Authors find general movement away from revenue sharing between 2009 and 2013:
  - Average payment falls from 20.6 bp to 15.1 bp
  - % Unaffiliated funds paying any revenue sharing falls from 59.5% to 51.7%
- Adding data for 2014 and 2015 should allow them to determine extent to which these changes are due to new regulation

3. Framing

- Should relate findings to two existing papers on the **macro** implications of changes in the level of indirect compensation
  - **Cookson et al. (RFS 2021)** find that fees fall when mutual funds can no longer compete for U.K. investment platform recommendations using commissions
  - **Sokolinski (2021; SSRN 3399000)** finds that Israeli equity fund fees fall and flows increase following differential reduction in commission rate

Conclusion

- Provocative paper exploiting cool new data
- To what extent do higher fees reflect agency conflict versus plan sponsor preference to pass greater % of admin costs along to participants?
  - Authors can answer this question by exploiting disclosures introduced in 2012
- **Promising question:** To what extent does higher recordkeeper bargaining power translate into higher recordkeeper revenues given existence of revenue sharing credits?