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Default Settings in Defined Contribution Plans – A Comparative Approach to Fiduciary Obligation and the Role of Markets

Dana M. Muir[1]

I. Introduction

The use of default settings in defined contribution (DC) plans is increasing both in the United States (U.S.) and in Australia. A variety of drivers are responsible for the use of default settings in these plans. Behavioral science research indicates that default settings may counteract the effect of inertia, which causes people to make less than optimal decisions in DC plans, and other impediments to optimal decision making.[2] Research on the effect of investment allocation in 401(k)[3] plan accounts on losses during the financial crisis highlighted the danger of investment allocations concentrated in high risk assets, particularly for participants close to retirement.[4] As a general policy matter, in the U.S. concern has long

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[2] *E.g.* RICHARD H. THALER & CASS R. SUNSTEIN, NUDGE, 107-17 (2008).

[3] 401(k) plans are a subset of U.S. defined contribution plans. For more detail on 401(k) plans, see EMPLOYEE BENEFITS LAW: SECOND EDITION 2010 CUMULATIVE SUPPLEMENT, 254-71 (Dana M. Muir ed. 2010).

[4] Jack VanDerhei, *The Impact of the Recent Financial Crisis on 401(k) Account Balances,* EBRI Issue Brief 326, http://www.ebri.org/pdf/briefspdf/EBRI_IB_2-2009_Crisis-Impct.pdf.

existed over the numbers of employees who do not participate in 401(k) plans even when they have the opportunity to do so.[5]

Although both countries have increased the use of default settings in DC plans, U.S. and Australian policy makers have taken different approaches to important aspects of default investment products. Both countries take a prescriptive approach to regulation. The net result of U.S. default regulation, however, is that employers are responsible as fiduciaries for the selection and monitoring of default (and all other) investment products offered in their plans. Other actors involved with the selection, monitoring and management of those investment products frequently have limited obligations to the plan participants whose retirement assets are invested.[6] To date, U.S. regulators have addressed issues observed with default investment products during the financial crisis by proposing that participants who hold certain types of default investment products receive additional disclosures. In contrast, Australia is in the process of setting strict substantive standards for the default investment products and enhancing the fiduciary obligations of the trustees responsible for the management and investment of those products.[7]

This Article begins, in Part II, with a very brief overview of the DC system in the U.S. and a more detailed discussion of the Australian system. Parts III and IV respectively turn to an analysis of the use of default settings in each country. Part V suggests two lessons for the U.S. in the Australian approach to default settings. First, U.S. policy should recognize that disclosure to

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[5] *E.g.* KAREN FERGUSON & KATE BLACKWELL, PENSIONS IN CRISIS: WHY THE SYSTEM IS FAILING AMERICA AND HOW YOU CAN PROTECT YOUR FUTURE, 176-78 (1995).

[6] *See infra* text accompanying notes 71-74.

[7] *See infra* Part IV.

and education of participants who are defaulted into investment products appears to be of limited value to those participants. Second, to the extent possible, the locus of fiduciary responsibility for default investment products should be on those who are expert on and manage those products.

II. Defined Contribution Systems and Trends

a. U.S. – The Trend to DC Plans and the Use of Defaults

As of June 30, 2011, employer-based DC plans in the U.S. were estimated to hold approximately $4.7 trillion in assets. 401(k) plan assets accounted for approximately $3.2 trillion of the total. As a comparison, Americans had $4.9 trillion invested in Individual Retirement Accounts (IRAs) and DB plans sponsored by private-sector employers held an estimated $2.5 trillion as of that date.[8] Some employers sponsor both DB and DC plans but for most employees in the U.S. who have an employment-based pension plan that plan now is a DC plan.[9] Thus DC plans, especially the 401(k) plans that will be the focus of the rest of this article, constitute an important component of the retirement planning of many Americans.

Default settings are used in three contexts in 401(k) plans.[10] First, when an employer chooses to sponsor a 401(k) plan, each employee eligible to participate in the plan typically has the right to decide whether or not to contribute. So, for example, a 401(k) plan may provide

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[8] *Retirement Assets Total $18.2 Trillion in Second Quarter,* (2011), http://www.ici.org/pressroom/news/ret_11_q2.

[9] William J. Wiatrowski, *Changing Landscape of Employment-based Retirement Benefits,* U.S. Bureau of Labor Statistics, http://www.bls.gov/opub/cwc/print/cm20110927ar01p1.htm.

[10] Typically these default settings are used in 401(k) plans.

only for voluntary employee contributions[11] and no employer contributions. An employee may choose not to contribute to such a plan. Other 401(k) plans provide for both employer and employee contributions but each employee still will have a choice of whether to contribute. In such a plan, entitlement to the employer's contribution may be dependent on the employee choosing to contribute.[12] In any of these plans the first question for the purpose of a default is how to set the default on participation. If an employee does not make an express decision on contributing, should the employee be defaulted into participation (contributing to the plan), an approach often known as automatic enrollment, or should the employee be defaulted out of participation (not contributing to the plan)?

Defaults operate at the second level in terms of the amount of an employee's participation. In the usual example, the employee has been defaulted into participating (contributing) to the plan. But, a determination – a default – needs to be made as to the amount of the employee's contribution. A variety of logical defaults exist. The default could be set at the maximum pre-tax contribution permitted by the Internal Revenue Code (IRC) rules that govern the plan.[13] In a plan with an employer match, the default could be set at the amount that would maximize the employer's contribution on behalf of the employee. A default

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[11] Although these are contributions that each employee may decide whether to make, for tax purposes technically they are characterized as employer contributions. *See* MUIR, *supra* note 3, at 256.

[12] *Id.* at 259-60.

[13] For a discussion of the Internal Revenue Code rules governing maximum pre-tax deferrals, *see* MUIR, *supra* note 3, at 257-58.

could be a fixed dollar amount across all employees, a fixed percentage, or could increase over time.[14]

The third level at which defaults operate is at the level of investment selection. Once an employee has been defaulted into a 401(k) plan and a default contribution has been determined, the contribution must be invested.[15] Investment defaults occur in other situations as well, including when an employee has elected to contribute to a plan but not selected an investment product.[16]

b. Australia – The Superannuation System

i. Brief History of Australia's "Mandatory" Occupational Pension System

Australia's pension system consists of three components, a government administered program somewhat similar to the U.S. Social Security system but with means testing, some tax incentives for individual savings, and an employment-based system.[17] The focus in this Article is on the third component of the Australian system – the employment-based component, which

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[14] *See, e.g.,* Shlomo Benartzi & Richard H. Thaler, *Save More Tomorrow: Using Behavioral Economics to Increase Employee Savings,* 112 J. Pol. Econ. S164 (2004) (evaluating a system where a participant's initial default contributions are set at 3.5% of salary but the rate increases at each of the participant's next four pay raises).

[15] This investment default may include only the 'employee's' contribution or may also include the amount matched or otherwise contributed by the employer.

[16] For discussion on U.S. investment default regulation, see *infra* Part III.

[17] For more extensive discussion of all three components of the Australian pensions system, see Dana M. Muir, *Building Value in the Australian Defined Contribution System: A Values Perspective,* 33 COMP. LAB. L. & POL'Y J. 93 (2011).

has come to be known as the Superannuation Guarantee (SG System).[18] The SG System developed in the early 1990s through the Australian system of setting wages and benefits by using industry awards.[19] In its first iteration the SG System required[20] employers to contribute three percent of most earnings for most employees to an individual DC account. The current rate of contribution is nine percent and that is scheduled to increase to twelve percent by 2020.[21]

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[18] APRA, *A recent history of superannuation in Australia,* 2, http://www.apra.gov.au/insight/upload/history-of-superannuation.pdf. Australians typically use the term "superannuation" to refer to retirement. One explanation is that pensions are thought to be annuity streams and lump sums historically were more common in Australia than annuities. INTERNATIONAL SOCIAL SECURITY ASSOCIATION ET AL., COMPLEMENTARY AND PRIVATE PENSIONS THROUGHOUT THE WORLD 2008 502 (2008,) [hereinafter ISSA, ET AL.].

[19] A more detailed history can be found at Muir, *supra* note 17, at 97-100.

[20] Technically contributions to the SG System are not mandatory. Instead, Australian law requires an employer who fails to make the minimum contribution to pay a charge (tax) to the government that is higher than the minimum contribution. As a result, there is a clear incentive to make the minimum contribution and commentators typically refer to the system as one of mandatory contributions. *See APRA, A recent history of superannuation in Australia, 4, http://www.apra.gov.au/insight/upload/history-of-superannuation.pdf*.

[21] *See Jeremy Cooper (chair), Final Report: Part Two: Recommendation Packages* 297 *[hereinafter Cooper Report, Part II], http://www.supersystemreview.gov.au/.*

Total superannuation assets were A$1.28[22] trillion as of September 2011. Coverage estimates from a 2007 survey indicate that 94 percent of Australian employees are members of the SG System.[23] Members[24] may begin withdrawing funds from their SG System accounts when they reach the "preservation age," which ranges between age 55 and 60, depending on their date-of-birth.[25]

In the early days of the SG System, nearly all contributions were made to what are known as industry funds. Those funds were established on an industry-by-industry basis and governance of the funds was divided between employers and employees. In mid-2005 members began to receive the right to choose both the 'fund' and the investment product within a fund to receive the SG System contributions made on their behalf. Fund choice gave rise to a new set of funds, for-profit funds known as retail funds, which are not affiliated with a particular industry.[26]

Default settings are used in fewer contexts in Australia than in the U.S. because of the structure of the SG System. Contributions to the system are mandatory for nearly all Australian workers so there is no need for a default setting on participation. The minimum level of contribution typically is determined either by the minimum statutory threshold, which currently

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[22] "A$" designates Australian dollars. The exchange rate as of December 14, 2011 was $1 = A$0.99 and can be calculated using the same calculator at http://www.exchangerate.com/.

[23] Australian Bureau of Statistics, *Trends in Superannuation Coverage,* 43 (2009) [hereinafter Trends], at http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/4102.0Main+Features70March%202009.

[24] "Members" is the term used in Australia for those who have SG System accounts. It is generally synonymous with the U.S. term "participant."

[25] [Cross-reference to Jonathon Forman's conference paper.]

[26] Muir, *supra* note 17, at 100.

is 9 percent, or through enterprise agreements or modern awards, the system that replaced industry awards, or employee contracts. So, there is no need in the SG System for an employer to set a specific default for the level of an employee's contribution. However, once SG System members received the right to choose both the fund and the investment product that would receive their contributions, investment default settings became important.[27]

ii. System as of 2010 and beyond

In June 2010, an expert panel that had been constituted by the Australian government issued a report, known as the "Cooper Report," on its findings and recommendations.[28] The Cooper Report contained ten packages of recommendations[29] that break down into 177 specific recommendations.[30] After reviewing the recommendations, the Australian government supported 139 of the recommendations[31] and in September 2011 issued the key design

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[27] See *infra* Part IV for a discussion of those default settings.

[28] Jeremy Cooper (chair), *Final Report: Part One: Overview and Recommendations* (2010) v-vi. [hereinafter Cooper Report, Part I], *http://www.supersystemreview.gov.au/*.

[29] Cooper Report – Part I, *supra* note 28, at 10.

[30] Cooper Report – Part II, *supra* note 21.

[31] *See* Australian Government, The Treasury, *Stronger Super – Government Response* [hereinafter Stronger Super – Government Response], http://strongersuper.treasury.gov.au/content/Content.aspx?doc=publications.htm. In parallel Australia is in the process of reforming its regulation of financial advisers, including those who provide advice to SG members. *See http://www.asic.gov.au/asic/asic.nsf/byHeadline/11-294AD%20ASIC%E2%80%99s%20plans%20for%20FoFA%20reforms?opendocument*.

elements of what it has named Stronger Super.[32] As of December 2011 the Stronger Super project is at the stage of being circulated as draft legislation.[33] This Article focuses on one specific component of Stronger Super – the development of a simplified SG System investment product that will be the only product eligible to serve as the default for members who do not select a fund or investment product. That simplified product is known as "MySuper." Members also will have the right to affirmatively choose a MySuper product to receive their contributions.[34]

The principles underlying MySuper are important in understanding the structure of MySuper. The Cooper panel believed that Australia's mandatory SG System should permit members to choose their level of engagement with the system. One of the ten principles forming the foundation of the Cooper Report included the statement that: "Financial literacy is

[32] Commonwealth of Australia, *Stronger Super: Information Pack,* Sept. 21, 2011, [hereinafter *Key Design*] http://strongersuper.treasury.gov.au/content/publications/information_pack/downloads/information_pack.pdf.

[33] The Parliament of the Commonwealth of Australia, *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012,* [hereinafter *Proposed Trustee and Prudential Provisions*] http://strongersuper.treasury.gov.au/content/exposure_drafts/trustee/downloads/trustee_ed.pdf; The Parliament of the Commonwealth of Australia, *Superannuation Legislation Amendment (My Super Core Provisions) Bill 2011,* [hereinafter *Proposed MySuper Core Provisions*] http://strongersuper.treasury.gov.au/content/exposure_drafts/mysuper_core_provisions/downloads/ed_mysuper.pdf.

[34] Cooper I, *supra* note 28, at 10.

an important long term goal, but a compulsory superannuation system cannot depend on all its participants having the skills necessary to comprehend complex financial information or being investment experts."[35]

Once the Cooper panel accepted the principle that not every member can or wants to develop the expertise to invest their retirement savings, then amendments to enable the SG System to accommodate that principle naturally followed. The panel's innovation was to suggest that individuals who do not want to be heavily involved in investment choice could opt into a MySuper product – or, in the absence of any choice at all, would be defaulted into a MySuper product. In general, SG System funds will each be permitted to have a single default MySuper investment product. MySuper products will provide only a limited menu of services and are expected to have relatively low fees that are charged in such a way as to be comparable across MySuper products. The Australian Prudential Regulatory Authority (APRA) will gather and report data on MySuper product performance and fees to facilitate competition among the offerings.[36]

III. U.S. Approach to Default Settings and Fiduciary Liability

a. The DOL and QDIAs

The U.S. landscape for the use of default settings in DC plans changed in 2006 with the passage of the Pension Protection Act (PPA),[37] which removed a number of barriers to the use of default settings. Although in 1998 and 2000 the Internal Revenue Service (IRS) had authorized the use of defaults to automatically enroll employees in 401(k) plans, few plans adopted

[35] Cooper Report – Part I, *supra* note 28, at 4.

[36] *See* Key Design, *supra* note 32, at v.

[37] Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 (2006).

defaults. Plan sponsors were concerned about their potential liability for choosing a default investment product, there were issues on how the defaults interacted with state statutes limiting wage garnishments, and there was no incentive for plan sponsors to automatically enroll employees in 401(k) plans.[38] The PPA provided an incentive for plans to use defaults and in 2007 the Department of Labor (DOL) issued final regulations that provide some protection from fiduciary liability for plan sponsors that select "qualified default investment alternatives" (QDIAs) as the plan's default investment product.[39]

Four categories of investment products qualify as QDIAs. A short-term, capital preservation product is permitted only for the first 120 days of an employee's plan participation. Of the three long-term QDIA options, one permits selection of a product that contains investments tailored to account for characteristics of the plan participants as a group. The other two QDIA options must be tailored to the characteristics of individual participants.[40] The regulations explicitly state that "targeted-retirement-date" funds, more commonly known as target date funds (TDFs), may qualify as a QDIA.[41] Of the 401(k) plans that contain an automatic enrollment default feature, approximately 60 percent have designated a TDF as the QDIA.[42]

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[38] Steven D. Cohen, Note, *Autoenrollment and Annuitization: Enabling 401(K) "DB-ation,"* 5 N.Y.U. J. L. & BUS. 281, 300-01 (2009).

[39] Fiduciary relief for investments in qualified default investment alternatives, 26 C.F.R. § 2550.404c-5 (2007).

[40] *Id.* at § 2550.404c-5(e)(4).

[41] *Id.* at § 2550.404c-5(e)(4)(i).

[42] Department of Labor, *Topic: QDIA -Target Date Fund Disclosure,* http://www.dol.gov/regulations/factsheets/ebsa-fs-QDIA-TDF.htm.

Neither the PPA nor the final regulation completely insulates plan sponsors from fiduciary duties regarding QDIAs. The fiduciary obligations of the actors involved with QDIAs, as with all plan-related investments, are determined by a patchwork of varying laws and exceptions.[43] ERISA governs the fiduciaries charged by the plan, typically the plan sponsor or a committee constituted of plan sponsor employees, with selecting and monitoring QDIAs and those fiduciaries must execute the duties prudently.[44] In contrast, according to long standing DOL regulations, which have been the subject of substantial recent debate, many of the entities and individuals that provide advice to plan fiduciaries in the choice of QDIAs are exempt from the ERISA fiduciary requirements.[45]

Entities and individuals, who provide investment advice, are subject to a variety of other federal and state laws depending on their status and the scope of advice they provide. In general those who are compensated for providing advice related to investments in securities are

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[43] A detailed discussion of the fiduciary obligations of the individuals and entities that provide investment advice to ERISA plans is beyond the scope of this article. For a more extensive analysis and discussion of the market for financial advice, see [cite DM/JT article].

[44] *See* C.F.R. § 2550.404c-5(b)(3).

[45] *See* Definition of the Term "Fiduciary," 65,263, Fed. Reg. 65,278, 65,265 (Oct. 22, 2010) (discussing the difficulties in establishing that investment advice providers are ERISA fiduciaries). In September 2011 the DOL withdrew the proposed rule and announced that it planned to re-propose it after revising some of its provisions. U.S. Department of Labor, *US Labor Department's EBSA to re-propose rule on definition of a fiduciary,* http://www.dol.gov/ebsa/newsroom/2011/11-1382-NAT.html.

subject to the Investment Advisers Act of 1940 (Advisers Act).[46] A number of exceptions exist from Advisers Act regulation.[47]

b. Proposed changes re: QDIAs

The global financial crisis and its impact on 401(k) plan investments has led the DOL and the Securities and Exchange Commission (SEC) to reconsider the regulation of TDFs in 401(k) plans, particularly when they are selected as QDIAs. To date the DOL's proposed regulatory revisions rely on enhanced disclosure to respond to the issues it observed with QDIAs. Specifically, the DOL's proposed regulations, developed in collaboration with the SEC, would require that participants in TDFs, including participants defaulted into those funds designated as QDIAs, receive information about the TDF. The disclosure must discuss asset allocation and how the allocation changes over time, the fees and costs, and a warning that losses are possible in TDFs.[48] In addition to the proposed amendments to disclosure regulations, the DOL and SEC held joint hearings in 2009 regarding TDFs.[49] As a result, in mid-2010 the two agencies published a joint investor bulletin intended to educate investors about TDFs.[50]

The DOL and SEC efforts to enhance disclosure about TDFs, although undoubtedly well intentioned, may have a limited or even a harmful effect. A significant body of research

[46] 15 U.S.C. §§ 80b-1 – 21 (2006).

[47] *See* John A. Turner & Dana M. Muir, *The Market for Financial Advisers* (manuscript on file with author).

[48] 75 Fed. Reg. 73,987 (Nov. 30, 2010) [Note: may have final regs prior to conference/publication]

[49] *DOL/SEC Hearing On Target Date Funds and Similar Investment Options,* http://www.dol.gov/ebsa/regs/cmt-targetdatefundshearing.html.

[50] Investor Bulletin: Target Date Retirement Funds, http://www.dol.gov/ebsa/pdf/TDFinvestorbulletin.pdf.

indicates that "mandated disclosure as a remedy . . . is often ineffective."[51] Studies in behavioral branches of psychology, economics and ethics as well as cognitive science indicate that disclosure often fails to enable the person receiving the disclosure to act rationally and may result in worse substantive behavior by the person providing the disclosure.[52] In addition, relying on disclosure to address a problem with default settings is inconsistent with a belief that one of the primary purposes of default settings is to permit people to remain disengaged from active decision making.

IV. Australian Approach to Defaults

a. "Current" default investments in superannuation funds

As noted above,[53] when Australians received the right to choose a fund and investment product to receive their SG System contributions, it became necessary to establish a default investment product for contributions in situations where a member did not make an affirmative investment choice. Australia used various mechanisms to determine the default investment product. In some instances the default fund and product were negotiated through enterprise agreements or modern awards. In other situations the employer typically selected a fund and product to receive contributions made on behalf of the employees. Regardless of whether the default fund and investment product were selected through enterprise agreements, modern awards or unilaterally by an employer, typically the relevant industry fund and its default investment product have been designated as the defaults.[54]

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[51] Robert A. Prentice, *Moral Equilibrium: Stock Brokers and the Limits of Disclosure,* [ ] WIS. L. REV. [ ], [conclusion] (forthcoming [2012]).

[52] *See generally id.*

[53] *See supra* text accompanying note 26.

[54] *See* Muir, *supra* note 17, at 100-01, 115.

Default products have proven to be popular in the SG System. In 2009, 68 percent of the assets held in industry funds were held in the default product of the particular fund.[55] And, eighty percent of the employees who default into a fund also invest in the fund's default investment product. The Cooper panel's research indicated that approximately eighty percent of those in the default investment product were defaulted into the product. The implication is that sixty percent of SG System members are defaulted into their investment product.[56]

b. New MySuper Program – Reforms in Progress

As discussed briefly above,[57] in 2010 the Cooper Report proposed a significant overhaul of many facets of the SG System. Australia is moving forward with most of the recommended reforms. As of this writing in December 2011, legislation has been proposed on most of the recommendations of import for this Article and this section discusses the reforms as outlined in the legislative proposals.[58]

The key reforms for purposes of this article are those related to development of MySuper products, which will serve as the default investments for individuals who do not choose an investment fund or product. MySuper products also will be an available investment option for SG System members who wish to elect a simple, diversified, low-cost investment product. MySuper products only may hold members' investments until they retire. Once

[55] APRA, Statistics: Annual Superannuation Bulletin June 2010, 40, at tbl. 18 (2011), available at http://www.apra.gov.au/Statistics/upload/June-2009-revised-Annual-Superannuation-Bulletin.pdfat 40..

[56] Cooper Report, Part I, *supra* note [], at 9.

[57] *See supra* text accompanying notes [ ].

[58] *Proposed Trustee and Prudential Provisions*, *see supra* note [ ]; *Proposed MySuper Core Provisions*, *see supra* note [ ].

members enter the decumulation phase, they must transfer their assets to another investment product.[59]

Trustees of MySuper products will be subject to an enhanced set of duties, which they will owe to members. Trustees, sometimes referred to as corporate trustees, are the entities that hold the SG System account assets and under Australian law they are fiduciaries. There is a basic set of requirements for SG System trustees that applies to all corporate trustees of funds that hold SG System assets. The enhanced obligations of MySuper trustees essentially will operate as an additional layer of duties. The enhanced duties required of MySuper trustees are to:

- promote the financial interests of MySuper members, in particular net returns;
- annually assess sufficiency of scale; and
- Include in their investment strategy an investment return target and level of risk for MySuper members.[60]

In addition the trustees must be licensed and meet specific standards with respect to the operation of a MySuper product.[61]

The trustees that hold SG System assets are governed by a board of directors, sometimes referred to as trustee-directors. The trustee-directors of any fund that offers a MySuper product also will be subject to an enhanced set of duties. Each trustee-director will have an obligation to ensure that the fund's corporate trustee fulfill its obligations, including the duties specific to MySuper products.[62]

[59] *Proposed MySuper Core Provisions*, *see supra* note [ ], at 6-7.

[60] *Proposed Trustee and Prudential Provisions*, *see supra* note [ ], at 8.

[61] *Proposed MySuper Core Provisions*, *see supra* note [ ], at 15.

[62] *Proposed Trustee and Prudential Provisions*, *see supra* note [ ], at 14.

The imposition of enhanced standards on the trustees and director-trustees of MySuper products is consistent with the Cooper Panel's finding that Australia's earlier grant to members of the right to choose investment funds and products failed to result in a competitive fund market and optimal investment decision-making. The panel observed that the failure of many members to affirmatively make a fund election contributed to the lack of an efficient market for SG System funds but other factors also contributed. According to the panel, members lack awareness of the performance and fees associated with their retirement investments in part because they do not actively make payments into their accounts and, in many cases, do not expect to access the funds for many years. In addition fund performance and fees often can be difficult to compare and switching funds takes effort and time.[63]

V. Lessons for the U.S.

In recent years the U.S. and Australia have increasingly recognized the value of default settings in defined contribution plans. The significant differences between their approaches to private-sector retirement plans carry over into the policy decisions they have made on default settings. Two characteristics of the Australian approach offer lessons for the U.S. First, Australia has recognized that many people who opt, implicitly or explicitly, into the default investment products do not want to be actively involved in monitoring the investments in their accounts. Second, employers also may not have the expertise or the inclination to become experts in investment product selection and monitoring.

a. Disclosure and Default Investment Products

Consider what the U.S. learned about default investment products from the financial crisis. With respect to TDFs, EBSA determined that some participants in TDFs designated as QDIAs had incurred significant losses because some TDFs had maintained substantial equity

[63] Cooper I at 7-8.

allocations even with near-term target retirement dates. EBSA's short-term response, coordinated with the SEC, was to issue an investor bulletin explaining the risks of investing in TDFs.[64] The bulletin contained three pages of useful information in an easy to read format combining charts and questions and answers.[65] In the longer term, EBSA has been drafting enhanced disclosure guidelines that would require plans to provide participants in QDIAs more information about those funds.[66] Ultimately that guidance and the required disclosures are likely to include valuable information for the plan sponsors and participants that read and understand them.

However, any approach that addresses issues with default investment products through education and disclosure is entirely inconsistent with the principles of a default regime. As Australia recognizes, no retirement system can rely on all individuals in the system to acquire and exercise the expertise required to make appropriate investment decisions. The U.S. implicitly decided that investment education and individual decision-making are of limited value for some participants when Congress provided, through the PPA, incentives for plans to implement automatic enrollment. There is nothing in the U.S. system of 401(k) and similar accounts that ensures that participants will read investor bulletins, disclosures delivered by their employers or any other investment-related materials, let alone that they will understand that material or take action based on it. Research indicates that many participants do none of those things. And, research on the efficacy of disclosure increasingly indicates that disclosures are

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[64] *See supra* text accompanying notes [ ].

[65] Department of Labor & Securities and Exchange Commission, *Investor Bulletin: Target Date Retirement Funds,* May 6, 2010, http://www.dol.gov/ebsa/pdf/TDFinvestorbulletin.pdf.

[66] *See supra* text accompanying notes [ ].

ineffective to address conflicts of interest.[67] That general research on disclosures is consistent with the research into heuristics and biases in 401(k) plan decision making.[68]

The success of a system of defaults, especially defaults into investment products, depends on the selection of appropriate default settings. It is incoherent to believe that default settings are important because an overwhelming array of research shows that individuals are subject to biases, lack interest in becoming investment experts, etc. and then, when it turns out that there may be issues with some default settings respond by providing information to those same individuals so they can determine whether the default settings are appropriate or not. By definition, the appropriate locus of decision making in default settings is not the individual plan participant. That raises the obvious question of where the locus of decision making and legal liability should be. On this point, Australia's approach also offers lessons for the U.S.

b. The Role of Employers and Financial Services Firms in a Default System

In the U.S., plan sponsors, or to be more transparent, the employers who voluntarily sponsor 401(k) and other DC plans, nearly always make the decisions on what investments are offered in those plans, including the decision on the plan's default option, typically a QDIA. In selecting the QDIA, the plan sponsor acts as a fiduciary, and must prudently select and monitor the QDIA.[69] Of course a plan sponsor that is not an expert on what investment products are the best choices for its employees may engage experts to provide advice on the selection and monitoring of QDIAs and the other available investment products. But, under current

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[67] *See* Prentice, *supra* note [ ].

[68] *See* Dana M. Muir, *The U.S. Culture of Employee Ownership and 401(k) Plans,* 14 ELDER L.J. 1, 14-17 (2006).

[69] *See supra* text accompanying notes [ ].

regulations, many of the individuals and entities that provide advice to employers on that decision are able to avoid fiduciary status.[70]

Consider a typical situation where the employer as a fiduciary, with the advice of a non-fiduciary does as most employers who choose QDIA's do and chooses a TDF, a species of mutual fund, as the QDIA. The entity that holds the TDF's assets is almost certainly an investment company subject to the Investment Company Act of 1940.[71] Professor Langevoort has succinctly explained the relationship between mutual funds and their investment advisers and highlighted the conflict of interest: "The typical mutual fund is organized by a sponsor who expects to profit by providing advisory and other services to the fund, with returns growing as the fund grows in size."[72] A review of the literature on the lack of competitiveness among mutual funds, the widespread violations of various laws through actions such as late trading, market timing, etc., the compensation levels of their advisers is beyond the scope of this Article. Suffice it to say here, a number of commentators argue that the current regulation of mutual funds has not given rise to a competitive market where mutual fund investors', particularly 401(k) investors', interests are the primary concern of mutual funds and their advisers.[73]

Australia is taking an approach to the regulation of MySuper products that differs significantly from the U.S. approach to QDIA and mutual fund regulation. Australian employers will be obligated to choose a MySuper product that is registered as such with ASIC. Employers will have access in making their choices to comparative data reported to and disseminated by

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[70] *See supra* text accompanying notes [ ].

[71] 15 U.S.C. §§ 80b-1 – b-21 (2006).

[72] Donald C. Langevoort, *Private Litigation to Enforce Fiduciary Duties in Mutual Funds: Derivative Suits, Disinterested Directors and the Ideology of Investor Sovereignty,* 83 WASH. U. L. Q 1017, 1019 (2005).

[73] *See, e.g., id.*

ASIC. There is little or no liability for an employer that chooses a MySuper product in this system if it turns out that the product has high fees, a poor investment strategy, or the product's trustee fails to execute its duties to fund members.

Instead, the trustees of the MySuper product bear not just the standard fiduciary obligations of fund trustees but also the enhanced responsibility to ensure that the investments and fees are appropriate for the employees whose retirement savings are invested in their MySuper product. Thus, in Australia, the responsibility for appropriate investment decisions, including decisions that affect product fees, coincides with both the locus of investment expertise and responsibility for investment strategy. Or, to state it slightly differently, the fiduciary responsibility owed to those whose retirement assets are invested with MySuper funds will reside with those with the expertise and power to manage funds.

VI. Conclusion

The U.S. and Australia have both increased the use of default settings in the employment-based DC components of their retirement income systems. This is consistent with a growing body of research that indicates that many employees do not want to actively manage their retirement savings and financial education may not be very effective. The difference between the two countries is that Australia is in the process of implementing a system of default investment products that recognizes and respects the different levels of involvement desired by different employees. That system of default investment products provides substantive protections for those who trust their retirement assets to the default system by holding accountable the providers of the default products. There are significant differences between the U.S. and Australian retirement systems, including the Australian mandatory contribution. However, the U.S. should consider whether a system that provides for default retirement investments owes more than just enhanced disclosure obligations to those who trust their retirement savings to the system. And, in a system of voluntary plan sponsorship, it is not obvious why the employers who sponsor DC plans should have fiduciary liability for the selection and monitoring of default investment products.