The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 23564

June 19, 2009

Rep. Neal Reintroduces Defined Contribution Plan Fee Transparency Act

[23564]

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TO: PENSION MEMBERS No. 28-09
FEDERAL LEGISLATION MEMBERS No. 5-09
BANK, TRUST AND RECORDKEEPER ADVISORY COMMITTEE No. 25-09
BROKER/DEALER ADVISORY COMMITTEE No. 32-09
OPERATIONS COMMITTEE No. 11-09 RE: REP. NEAL REINTRODUCES DEFINED CONTRIBUTION PLAN FEE TRANSPARENCY ACT

Representative Richard Neal (D-Ma) reintroduced the "Defined Contribution Plan Fee Transparency Act of 2009" (H.R. 2779) which would require certain disclosures to be provided by plan administrators to participants, and by plan service providers to plan administrators. The bill amends the Internal Revenue Code by adding two new excise tax provisions that apply if the bill's disclosures are not provided. A copy of the bill's text is attached.

The bill retains a similar structure to the legislation Rep. Neal introduced in the previous Congress (H.R. 3765) [1] although a number of changes have been made, both substantive and technical. Some (but not all) of these changes are noted below. In addition, the bill includes a new provision relating to electronic disclosure.

Participant Disclosures

The participant disclosures under the bill would apply to any participant-directed defined contribution plan that is a qualified plan, 403(a) annuity plan, governmental 457(b) plan, or 403(b) plan.

Enrollment and Annual Disclosure

The bill would require that a plan administrator [2] provide to eligible employees, a reasonable time prior to initial investment, [3] a written explanation of the plan's fees and expenses, the key characteristics of the plan's investment options, and an explanation of how to make investment elections.

In order to comply, [4] the written explanation must provide a description of the following:

- The designated investment alternatives available to a participant under the plan, the method for a participant to make investment elections, and an explanation of any specified limitations on those elections under the documents and instruments governing the plan, including any restrictions on transfer to or from an investment alternative.
- For each of the plan's investment alternatives:
    - a general description of the alternative's investment objectives and principal investment strategies, principal risk and return characteristics, and the name of the alternative's investment manager,
    - whether the alternative is actively managed or passively managed in relation to an index and the difference between active management and passive management;
    - whether the alternative is designed to be a comprehensive, stand-alone investment for retirement that provides varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures;
    - rates of return for the investment alternative over the immediately preceding 1-, 5-, and 10-year periods (determined on either a calendar or plan year basis);
    - the name and returns of an appropriate broad-based securities market index over the preceding 1-, 5-, and 10-year periods, which is not administered by the service provider or an affiliate unless the index is widely recognized and used;
    - fees and expenses in connection with purchases or sales of interests in the investment alternative, such as sales loads, sales charges, deferred sales charges, redemption fees, surrender charges, exchange fees and other similar fees and expenses; and
    - the total operating expenses for the alternative.
- If applicable, a statement that the fees and expenses of the investment alternatives pay for services other than investment management.
- Annual fees and expenses for administration and recordkeeping which are deducted from (or reduce the income of) participants' accounts and which are not reflected in the operating expenses of the investments, and a statement of the method used to allocate these fees and expenses to participants' accounts.
- The existence of fees and expenses associated with participant-initiated transactions or services which may be deducted from participants' accounts and the method that participants may utilize to obtain additional information regarding those fees and expenses.

- Any other fees and expenses which may be deducted from participants' accounts.
- Where and how additional alternative-specific and generally available investment information may be obtained (such as an Internet Web site address).
- A statement explaining that investment alternatives should be selected not only on the basis of the level of fees charged by each alternative but also on the basis of consideration of other key factors, including the alternative's investment objective, level of risk, historic rates of return and the participant's personal investment objective.

The above information must be provided at least annually to current participants. The bill also requires affected participants be provided this enrollment disclosure again in advance of any change to the investment options available under the plan (except in appropriate circumstances to be determined by Treasury regulations).

Quarterly Disclosure

The bill would require that participants receive, each quarter, information on the participant's account as of the last day of the preceding quarter:

- The asset classes that the participant is invested in and the percentage allocated to each asset class;
- The total fees and expenses for administration and recordkeeping deducted from the participant's account;
- The total fees and expenses for participant initiated transactions deducted from the participant's account;
- Fees and expenses in connection with purchases or sales of interests in investment alternatives deducted from the participant's account;
- Any other fees and expenses deducted from the participant's account; and
- For each investment option in which the participant was invested as of last day of the quarter:
    - The percentage of the account invested in the option;
    - Whether the option is active or passively managed;
    - A general statement of the principal risk and return characteristics of the option; and
    - Total annual operating expenses for the investment alternative.

The annual notice also must include a statement similar to the statement provided at enrollment that investments should be selected not only on the basis of fees but also based on other key factors, and must include a statement of how a participant can access the information in the enrollment disclosures.

Penalties

Failure to meet the participant notice requirements results in an excise tax imposed on the employer maintaining the plan of $100 per day per participant, not to exceed the lesser of

10 percent of the assets of the plan or $500,000 per plan year. The tax does not apply if waived by the IRS or if the employer exercised reasonable diligence and corrects the failure within 90 days.

A new provision added to the bill provides that a plan administrator may rely on information provided by a service provider unless the plan administrator knows, or has reason to know, that the information is inaccurate or incomplete, or has notice of facts or information that would prompt a reasonable plan administrator to inquire into the accuracy or completeness of the information.

Form and Content of Notices

The bill allows fees and expenses to be expressed as a dollar amount or as a percentage of assets (or a combination of the two). A new provision requires that if fees and expenses are expressed as a percentage of assets, participants must be provided a generic example that illustrates how a charge that is expressed as a percentage of assets is assessed in dollars on an account balance.

The bill also allows reasonable estimates to be provided, and for the quarterly notice, for the estimate to be based on fees and expenses as of any date on or after the last day of the preceding plan year (but prior to the date the quarterly notice is provided). A plan administrator need not use the same methodology for every investment alternative. Treasury is directed to prescribe models for the participant notices. The bill requires that explanations and notices must be provided in a manner which is easily understandable by the typical plan participant.

Treasury is also required to issue regulations identifying and establishing separate rules for any investment options that provide a guaranteed rate of return and do not identify specific fees.

Service Provider Disclosures

The new service provider disclosures under the bill would apply to any defined contribution plan (whether or not participant-directed) that is a qualified plan, 403(a) annuity plan, governmental 457(b) plan, or 403(b) plan. The service provider disclosures described below must be provided to participants upon request. [5]

Initial Disclosure to Plan Administrator

The bill would require that a service provider [6] provide a plan administrator an initial written disclosure prior to entering into or materially modifying a contract for plan services. The initial disclosure must include:

- An estimate of the total fees and expenses expected to be paid under the contract;
- The services to be provided by the service provider, its affiliates and any subcontractors under the contract;
- A schedule of fees and expenses associated with participant-initiated transactions or services;
- The amount of any fees and expenses the service provider reasonably expects to pay under the contract to third-party service providers or intermediaries (and the identity of each), including commissions, finders fees, sales loads and charges;
- Any amount the service provider expects to receive from a source other than the plan or plan sponsor in connection with services provided to the plan (and the identity of each source);
- A statement whether the service provider or an affiliate may benefit from the offering of its own proprietary investment products or those of a third party; and
- To the extent applicable, a statement that the investment options available to the plan may be offered at different price levels to parties other than the plan.

For a contract that provides for both investment management and administration and recordkeeping, the estimate of total fees and expenses must itemize the annual fees between investment management on the one hand and administration and recordkeeping on the other.

If a service provider does not separately price investment management and recordkeeping and administration, the provider may allocate fees and expenses among those components in a manner that is reasonable and in good faith. A new provision added to the bill requires Treasury to issue regulations that include safe harbors for the allocation under which service providers will be treated as having reasonably allocated fees and expenses but which are not the exclusive methods for making the allocation.

Service providers, affiliates and subcontractors whose fees and compensation in connection with the services arrangement are not reasonably expected to equal or exceed $5,000 are not subject to the disclosure requirements.

Annual Disclosure to Plan Administrator

The bill would require that each year, by the due date for filing the plan's Form 5500 (without regard to extensions), the service provider must provide the plan administrator with a statement of the fees and expenses under the arrangement during the plan year, including itemization of investment management and administration and recordkeeping and itemization of amounts paid to third-party service providers. The annual statement must include the amount the service provider received from sources other than the plan or plan sponsor in connection with services provided to the plan (and the identity of each source).

Penalties

Failure to meet the disclosure requirements would result in an excise tax on the service provider of $1,000 per day per plan, not to exceed the lesser of 10 percent of the assets of the plan or $1,000,000 per calendar year. The tax does not apply if waived by the IRS or if the service provider exercised reasonable diligence and corrects the failure within 90 days.

A new provision added to the bill provides that a service provider may rely on information provided by a service provider that is not an affiliate unless the service provider knows, or has reason to know, that the information is inaccurate or incomplete, or has notice of facts or information that would prompt a reasonable service provider to inquire into the accuracy or completeness of the information.

Form and Content of Notices

The bill allows fees and expenses to be expressed as a dollar amount or as a percentage of assets (or a combination of the two). The bill also allows reasonable estimates to be provided. For disclosure of payments the service provider pays to or receives from third parties, no disclosure is required if the amounts are not expected to exceed $5,000.

The bill requires that explanations and notices must be provided in a manner which is easily understandable by the typical plan administrator.

Electronic Disclosure

The bill includes a new provision directing Treasury to update its electronic disclosure regulations no later than six months after enactment so that notices required to be provided to a recipient under a qualified plan, 403(a) plan, 403(b) plan, SEP, SIMPLE IRA, or governmental 457(b) plan may be provided electronically. This provision would apply to all notices required with respect to these plans, not just the new disclosures required by the bill.

Under the provision, a notice is treated as providing in writing if:

- the applicable notice is posted on a secure Internet Web site that is accessible to the participant or beneficiary;
- a notice of the availability of the notice is provided in writing or in a manner that satisfies Treasury regulation section 1.401(a)-21 (i.e. electronically under current Treasury regulations) at the same time that the notice is otherwise required; and
- the notice of availability advises the recipient that he or she may request and receive the notice in writing on paper at no charge and, upon request, the notice is provided in writing on paper to the recipient at no charge.

Effective Date

The bill would be effective for plan years beginning after one year after enactment. Treasury would be directed to issue final regulations no later than December 31, 2010.

Comparison to H.R. 1984

The House Education and Labor Committee is considering H.R. 1984, introduced by Representative George Miller. [7] Although the Neal and Miller bills both cover disclosure, there are many differences in language which could lead to significantly different disclosure. For example, unlike H.R. 2779, H.R. 1984 includes provisions defining services to include the "offering" of an investment option to the plan, generally requires disclosures to employers and participants to be converted to dollar figures, and does not contain provisions allowing for correction of inadvertent errors. The bills differ significantly in their approach to allocation of components of a service contract. H.R. 2779 would not mandate that plans offer an index fund meeting specific requirements. H.R. 1984 would only amend ERISA and does not contain Internal Revenue Code excise tax provisions.

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Attachment

endnotes

[1] See Institute Memorandum to Pension Members No. 56-07, Federal Legislation Members No. 8-07, Bank, Trust and Recordkeeper Advisory Committee No. 40-07, Broker/Dealer Advisory Committee No. 63-07 and Operations Committee No. 27-07 [21760], dated October 5, 2007.

[2] Plan administrator has the meaning in Code Section 414(g), which is either the person or persons named in the plan document or, if no one is named, the employer or employer organization that maintains the plan.

[3] Treasury is directed to issue regulations allowing the enrollment notice to be provided after initial contribution for plans that provide for automatic enrollment.

[4] The previous version of the bill made the specific requirements essentially a safe harbor for the general notice requirement.

[5] The previous version of the Neal bill required that this also be posted on a website for participants.

[6] All corporations that provide services to a plan and are members of a controlled group

of corporations within the meaning of Code section 1563(a) (determined without regard to subsections (a)(4) and (a)(5)) are treated as a single service provider.

[7] For a description of H.R. 1984, see Institute Memorandum to Pension Members No. 19-09, Federal Legislation Members No. 3-09, Bank, Trust and Recordkeeper Advisory Committee No. 18-09, Broker/Dealer Advisory Committee No. 22-09 and Operations Committee No. 8-09 [23419], dated April 24, 2009. H.R. 1984 has been approved by a Subcommittee of the Education and Labor Committee. See Institute Memorandum to Federal Legislation Members No. 4-09, Bank, Trust and Recordkeeper Advisory Committee No. 24-09, Broker/Dealer Advisory Committee No. 31-09 and Operations Committee No. 10-09 [23563], dated June 19, 2009.
