

MEMO# 22086

January 2, 2008

Senators Harkin and Kohl Introduce 401(k) Disclosure Bill

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TO: PENSION MEMBERS No. 1-08
FEDERAL LEGISLATION MEMBERS No. 1-08
BANK, TRUST AND RECORDKEEPER ADVISORY COMMITTEE No. 1-08
BROKER/DEALER ADVISORY COMMITTEE No. 1-08
OPERATIONS COMMITTEE No. 1-08 RE: SENATORS HARKIN AND KOHL INTRODUCE 401(k) DISCLOSURE BILL

Senators Tom Harkin (D-IA) and Herb Kohl (D-WI) have introduced the “Defined Contribution Fee Disclosure Act of 2007” (S. 2473) to create additional sponsor- and participant-level disclosure requirements under ERISA and require the Department of Labor to publish survey information on median fee levels of certain types of funds. A copy of the bill is attached.

Many of the disclosure requirements of S. 2473 are similar to H.R. 3185, [1](#) introduced by Representative George Miller (D-CA) in July 2007, although the two bills differ in a number of details. In addition, unlike H.R. 3185, S. 2473 would not require a plan to include an index fund among its options.

Disclosure to Plan Administrators

S. 2473 would prohibit a plan administrator of a 401(k) or a 403(b) plan subject to ERISA [2](#) from contracting with a service provider unless the plan administrator received in advance a written statement identifying the services to be provided under the contract, who will provide services to the plan, total annual charges for the services, and an allocation of the total annual charges among all “relevant components.” At a minimum, the total annual charges must be allocated among: investment management, recordkeeping and administration, sales charges, and any other charges. Total annual and component charges may be disclosed in dollar amounts or through a formula, provided the form is consistent throughout the disclosure.

The statement must disclose payments a service provider receives from an unaffiliated

person in connection with the provision of services, including payments for including investment options on a menu. The statement must disclose any financial or personal relationship the service provider has with the plan sponsor, the plan or another person providing services to the plan, if the relationship results in the service provider deriving any additional material benefit, including through proprietary fund offerings. [3](#)

The statement must disclose that share prices of certain mutual funds may be different from those outside the plan due to the existence of different share classes, and the statement must disclose the basis for these differences. The statement also must disclose the extent and amount of any payments received by a service provider, directly or indirectly, by means of charges against participant accounts that allow the provider to offer its services without charge or at a discount. [4](#)

An updated statement must be provided to the plan administrator at least annually and as soon as practical after any material change in the information. The statement must be made available to participants who request it.

The disclosure requirement would not apply to any contract if the total cost for services was less than the greater of \$5,000 or 0.01 percent of plan assets as of the last day of the preceding plan year. The disclosure also is not required for any contract under which payment for services does not involve assets of the plan.

The bill would require the Department of Labor to prescribe regulations identifying investment alternatives that may not have specific fees associated with them, including investments that provide a guaranteed rate of return, although the bill does not state what disclosure requirements, if any, would apply to the products DOL identifies.

Disclosure to Participants

The bill would require the plan administrator of a participant-directed individual account plan to provide participants certain information upon commencement of participation and prior to the effective date of any change in investment options. [5](#) The notice must set forth, for each investment option:

- investment objectives,
- level of risk,
- whether the option is a comprehensive investment designed to achieve long-term retirement security or should be combined with other options,
- whether the option is actively or passively managed,
- the historical return and percentage fee assessed against amounts invested under the option,
- a comparison to a nationally recognized market-based index or other investment option that is recommended in the retirement industry as a benchmark retirement investment option (which DOL will identify), and
- where additional plan- and option-specific and generally available investment information regarding the option may be obtained.

The notice must include a statement that investment options should not be selected solely on the basis of fees but also on careful consideration of other key factors.

Participants also must receive an investment comparison chart [6](#) describing the service fees that could be assessed against their accounts, in four categories: fees that vary depending on the investment option chosen, fees that are assessed as a percentage of

total assets in the account, [7](#) administration and transaction-based fees, and any other fees not falling into the first three categories. Similar disclosure must be provided upon request.

The bill would add additional disclosures to the quarterly benefit statement requirement created by the Pension Protection Act of 2006. [8](#) With respect to the portion of a participant's account that the participant has the right to direct, the statement must disclose:

- the starting and ending balance;
- the vesting status;
- contributions itemized by employer and employee;
- interest earned during the quarter;
- actual or estimated fees assessed during the quarter, expressed in dollars or as an expense ratio;
- the participant's asset allocation, categorized by option, including the current asset value, the changes in asset value, and the net return expressed as an amount and a percentage; and
- the performance of each investment option compared to an index identified by DOL.

The bill also would require the statement to include the estimated amount that the participant needs to save each month to retire at age 65. [9](#) The bill does not explain on what basis Congress would expect plans to make these estimates.

The bill would require the Department of Labor to prescribe regulations identifying investment alternatives that may not have specific fees associated with them, including investments that provide a guaranteed rate of return, although the bill does not state what disclosure requirements, if any, would apply to the products DOL identifies. DOL also must prescribe regulations for "distinct reporting" of investment alternatives that are difficult to value on an annual basis or which do not have generally accepted comparison benchmarks.

Estimates and Model Statements

S. 2473 at various points allows disclosure of reasonable estimates when the actual amount is not known and requires DOL to issue model disclosure notices. The bill would allow disclosures to be made electronically under rules similar to the IRS' rules for electronic disclosure.

Enforcement

DOL could assess a penalty of up to \$100 per day for failure to provide the required disclosure to plan administrators and participants. [10](#) DOL would be required to notify the SEC, the Comptroller of the Currency, or other regulator if DOL determines a service provider is engaged in a pattern or practice that precludes plans from complying, and to disseminate widely the service provider's identity. [11](#)

Fee Survey and Annual Audit

S. 2473 would require DOL to survey and publish annually data on plan investment options and median fee levels of index, lifecycle, and balanced fund options, and any other investment options DOL determines. DOL would be required to conduct an annual representative audit of plans to determine compliance with the disclosure requirements, the results of which must be reported to the House and Senate committees with jurisdiction over ERISA. DOL also would be required to make recommendations to Congress within 18

months after enactment on how to simplify and improve reporting and disclosure requirements.

Michael L. Hadley
Associate Counsel

[Attachment](#)

endnotes

[1](#) See Memorandum to Pension Members No. 44-07, Federal Legislation Members No. 4-07, Bank, Trust and Recordkeeper Advisory Committee No. 35-07, Broker/Dealer Advisory Committee No. 43-07 and Operations Committee No. 19-07 [21396], dated July 27, 2007.

[2](#) The provision requiring disclosure to plan administrators applies only to defined contribution plans that have a qualified cash or deferred arrangement under Code section 401(k)(2) or that are 403(b) annuity contracts. The provision would not apply to 403(b) plans not subject to ERISA, other defined contribution plans or defined benefit plans. The provisions of the bill requiring disclosure to participants would apply to all participant-directed individual account plans subject to ERISA.

[3](#) The legislation would authorize the Department of Labor to specify other similar arrangements that must be disclosed.

[4](#) DOL may provide for an exception for small plans from this requirement if DOL determines the requirement to be overly burdensome.

[5](#) Generally the notice must be provided at least 15 days prior to initial investment and the effective date of any changes, but the bill contains exceptions for automatic enrollment and situations similar to those in which a blackout notice may be delayed (ERISA § 101(i)(2)(C)).

[6](#) This is called a “fee menu” in H.R. 3185.

[7](#) This category must include a statement noting fees and expenses of one or more investment options that pay for services other than investment management and explaining that investment options should be selected not only on the basis of fees charged but also based on careful consideration of other key factors.

[8](#) ERISA § 105(a). The bill would allow plans with fewer than 100 participants to provide the information on an annual rather than quarterly basis.

[9](#) Disclosure of the estimated amount the participant needs to save is optional in H.R. 3185.

[10](#) The bill would add the civil penalty to ERISA section 502(c)(7). This section states that each violation with respect to any single participant or beneficiary is treated as a separate violation.

[11](#) A service provider must be provided notice and an administrative hearing and appeal prior to the dissemination of its identity.

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