The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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Rep. George Miller Reintroduces 401(k) Fair Disclosure for Retirement Security Act

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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
OPERATIONS COMMITTEE No. 8-09 RE: REP. GEORGE MILLER REINTRODUCES 401(K) FAIR DISCLOSURE FOR RETIREMENT SECURITY ACT

Representative George Miller, Chairman of the House Education and Labor Committee, reintroduced the "401(k) Fair Disclosure for Retirement Security Act of 2008" (H.R. 1984). The bill is very similar to the bill that the Education and Labor Committee approved last year but which was not brought to the House floor (H.R. 3185). [1] The most significant change is related to the mandated index fund, described below.

Representative Robert Andrews, Chairman of the Subcommittee on Health, Employment, Labor, and Pensions, held a hearing on the bill on April 22. [2] A copy of the bill's text is attached.

Revised Index Fund Requirement

H.R. 1984 includes a mandated index fund that has been modified from the version of H.R. 3185 reported out of the Education and Labor Committee. The bill would provide that

ERISA § 404(c) [3] will not be available to a plan fiduciary unless the plan includes at least one investment option meeting three requirements:

- The investment option must be an "unmanaged or passively managed mutual fund with a portfolio of securities designed to substantially match the performance of the entire United States equity market or the entire United States bond market, or a combination thereof."
- The investment must offer "a combination of historical returns, risk, and charges . . . that is likely to meet retirement income needs at adequate levels of contribution."
- The plan's terms must describe the investment option "as offered without any endorsement of the Government or the plan sponsor.''

Disclosure to Plan Administrators

The bill would prohibit a plan administrator of an individual account plan [4] from contracting with a service provider unless the plan administrator receives, at least ten business days in advance, a single written statement which describes the services that will be provided to the plan in connection with the contract and provides the expected total annual charges and an allocation of those total annual charges among four components. The offering of an investment option to a plan is specifically included as a contract for services covered by the bill. [5]

This disclosure requirement applies only if the total charged for services equals or exceeds $5,000. [6] The Department of Labor may specify a lesser threshold for small plans and a greater threshold for other plans.

The total annual charges must be allocated into the following components:

- charges for plan administration and recordkeeping;
- transaction-based charges; [7]
- charges for investment management; and
- other charges as specified by the Department of Labor.

The annual charges for plan administration and recordkeeping and investment management must be presented as an aggregate total dollar amount (and also may be presented as a percentage of assets). Transaction-based charges may be presented either as dollar amount or as a percentage of the "applicable base amounts." Reasonable estimates may be used but must be based on the previous year's experience, except in the case of a new plan, in which case the estimate must be based on the previous year's experience of a comparable plan with participants of similar demographics. [8]

Service providers may rely on information given by an unaffiliated person regulated by the Federal government or a state unless the service provider knows or has reason to know the information is inaccurate or incomplete or has notice of facts that would prompt a reasonable service provider to inquire into the accuracy or completeness of the information.

The single written statement must include a number of disclosures regarding conflicts of interest, share class, and discounted services:

- Payments and services from affiliates and third parties. The service provider must disclose any payment, or the amount representing the value of any services, provided to the service provider (or its affiliate) pursuant to or in connection with the contract. The disclosure must describe the amount and type of any payment made or credit received, and is required regardless of whether the person providing the services is affiliated with the plan, the plan sponsor, the plan administrator, or any other plan official.

- Personal and business relationships. The service provider must disclose any personal, business or financial relationship with the plan sponsor, the plan, or the service provider, or any "totality of such relationships" which is material, if the relationship results in the service provider deriving any material benefit. The bill requires disclosure of the extent to which the service provider or its affiliate may benefit from offering its own proprietary investment products or those of a third party.

- Other similar relationships. DOL may specify "similar" relationships benefiting the service provider that must be disclosed.

- Mutual fund share classes. The single written statement must disclose, to the extent applicable, "that the share prices of certain mutual fund investments that are available to the plan may be different from the share price outside of the plan due to the existence of different share classes and provide the basis for those differences."

- "Free or discounted" services. If services are provided without explicit charge or at discount or subject to rebate, the single written statement must specify the consideration otherwise obtained by the service provider or an affiliate, the plan, or the plan sponsor for the services, directly or indirectly, by charges against participant accounts.

Under the bill, every contract for services must require that the service provider provide an updated written statement describing any material change as soon as reasonable after the change is known. The contract must provide that the single written statement is provided at least annually (even if there has been no material change during the year).

The bill provides that nothing in the law shall be construed to require any service provider to provide any services and provides that nothing in the law affects the obligations of plan sponsors and fiduciaries under ERISA's fiduciary rules.

Disclosure to Participants of Investments and Fees

The bill would require the plan administrator of a participant-directed individual account plan to provide information on investment options and fees at least ten business days prior to the date of a participant's initial investment (or the effective date of any material change in investment options). [9] The notice also must be provided each plan year. The notice may be combined with the default investment notice required by ERISA § 404(c)(5). The notice must specify which components of charges for each investment option are payable by the participant and how these components will be paid.

For each available investment option, the notice must provide:

- the name of the investment option;
- the investment objectives and principal investment strategies;
- the risk level associated with the option;
- whether the option is diversified among various classes of assets to minimize the risk of large losses or should be combined with other options to obtain such diversification;
- whether the investment option is actively or passively managed in relation to an index and must explain the difference between active and passive management;
- where, and the manner in which, additional plan-specific, option-specific, and generally available investment information regarding the option may be obtained; and
- a statement explaining that investment options should not be evaluated solely on the basis of the charges for each option but should also be based on careful consideration of other key factors, including the risk level of the option, the investment objectives of the option, the principal investment strategies of the option, and historical returns derived by the option.

The plan administrator must include a plan fee comparison chart comparing actual service and investment charges (including charges for the "offering of an investment option") that will or could be assessed against the account of the participant with respect to a plan year. The fees listed on the comparison chart must be in the form of a dollar amount (although percentage of assets may also be listed). The chart must include examples that demonstrate how the charges will be assessed against the account of the participant and

any other information DOL determines necessary to permit participants to assess the services for which charges will or could be assessed.

The comparison chart must provide information in relation to four categories of charges:

- Charges that vary depending on the investment options selected by the participant, including expense ratios and investment-specific asset-based charges. The information relating to these charges must include a statement noting any charges for investment options that pay for services other than investment management.
- Charges assessed as a percentage of the total assets in the account of the participant, regardless of investment option selected.
- Administration and transaction-based charges that are not assessed as a percentage of total assets and are either automatically deducted or result from certain transactions engaged by the participant. [10]
- Any other charges that may be deducted from participants' accounts not described above.

In addition, each charge must be described by whether it is for investment management, transactions, plan administration and recordkeeping, or other identified services. The fee comparison chart must include the amount of fees assessed in connection with each investment option and a history of returns derived net of fees and expenses, for the previous year, five years, and ten years (or since inception).

Reasonable and representative estimates for the information required above are allowed, as long as they are identified as estimates and based on the previous year's experience except in the case of a new plan, in which case they must be based on the previous year's experience of a comparable plan with participants of similar demographics.

Regulations Regarding Specified Products

DOL is required to prescribe regulations identifying (and establishing separate rules, if necessary, to identify) any investment options that provide a guaranteed rate of return and that do not identify specific fees.

Definitions

The bill includes the following definitions which apply to both the service provider and participant disclosures:

- Charge: in connection with any service provided to the plan or any financial product provided to the plan in which plan assets are invested, any fee, credit, or other compensation charged or paid for the service or product, including money and any other thing of monetary value to be received by the provider of the service or product, or its affiliate, in connection with the service or product.

- Service: a service provided directly or indirectly to, or with respect to, the plan or a service provided directly or indirectly in connection with a financial product in which plan assets are to be invested.

- Contract: in connection with any two or more parties, any contract or arrangement entered into between or among such parties, and any extension or renewal thereof.

- Service provider: in connection with a service, a person directly or indirectly providing the service.

Quarterly Benefit Statements

The bill would modify the new PPA pension benefit statement by adding new requirements for participant-directed plans. For the portion of the account for which the participant has the right to direct investments, the following information must be provided:

- the starting balance and ending balance of the account;
- contributions made during the quarter, itemized by employer and employee contributions;
- investment earnings or losses during the quarter;
- actual or estimated charges [11] which reduce the account during the quarter expressed in dollars or, if estimated, the estimated dollar amount derived from an expense ratio, which may be expressed as a specific date estimate based on the previous year's expense ratio;
- any other charges to the participant in connection with the account;
- the participant's asset allocation, including the net return, expressed as an amount and as percentage; and
- how to obtain the most recently updated fee comparison chart.

The quarterly benefit statement may, but is not required to, provide the historical return and risk of each investment option and the estimated amount that the participant needs to contribute each month so as to retire at his or her Social Security retirement age.

If a plan has fewer than 100 participants, the plan may comply with the pension benefit statement requirements on an annual rather than quarterly basis.

Use of Electronic Media and Model Notice

The bill provides that the plan administrator or participant disclosures may be made by electronic medium under rules prescribed by DOL, which must be similar to those applicable under the Internal Revenue Code for participant notices. DOL's rules must provide for a method, designed so not to be overly burdensome for the average participant, to obtain a paper copy upon request.

DOL is directed to prescribe a model statement and notice for the service provider and participant disclosures.

Effective Date

The bill would make the new disclosure and index fund requirements described above effective for plan years beginning one year after enactment.

Enforcement

The bill provides a $1,000 per day penalty for a service provider (as defined earlier), subject to a maximum penalty of 10 percent of the "amount involved," if the plan administrator disclosure provision is violated. [12] The bill also provides for a $100 per day penalty for a plan administrator or service provider that fails or refuses to provide the participant investment disclosure or the quarterly benefit statement. DOL may modify the penalty if it determines that the person acted reasonably and in good faith or that severe hardship would otherwise occur to the plan sponsor and that the modification is in the interests of participants.

DOL is required to notify the applicable regulatory authority if DOL determines that a service provider is engaged in a pattern or practice that precludes compliance by plan administrators and to widely disseminate the service provider's identity. [13]

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Attachment

endnotes

[1] See Institute Memorandum to Pension Members No. 24-08, Federal Legislation Members No. 5-08, Bank, Trust and Recordkeeper Advisory Committee No. 12-08, Broker/Dealer Advisory Committee No. 12-08 and Operations Committee No. 9-08 [22442], dated April 18, 2008.

[2] For more information and to see a webcast of the hearing, go to http://edlabor.house.gov/hearings/2009/04/401k-fair-disclosure-for-retir.shtml. Rep. Andrews, as well as eight other House Democrats, are co-sponsors of H.R. 1984.

[3] ERISA § 404(c) provides relief for plan fiduciaries when a plan allows participants to direct the investment of their account. Essentially, fiduciaries are relieved from losses resulting from the investment decisions of participants.

[4] The plan administrator disclosure requirements apply to all ERISA-governed individual account plans (not just participant-directed 401(k) plans), including ERISA covered 403(b) plans and other defined contribution plans.

[5] It is unclear whether this would subject the underwriter and/or distributor of a mutual fund to the requirements of the bill or simply refers to recordkeepers who contract with plans and who offer access to a menu of investments.

[6] The $5,000 amount would be increased for cost of living for calendar years beginning after 2010.

[7] This would appear to apply to sales loads and transaction costs associated with acquiring or selling a plan investment, as well as charges for accessing specific plan services such as loans. It is not clear whether or not this includes commission costs for a mutual fund's portfolio trading.

[8] The provision to address new plans was not in H.R. 3185.

[9] The bill would allow plans with immediate eligibility or that have an automatic contribution arrangement to provide the information within any reasonable period prior to initial investment. DOL must prescribe exceptions for circumstances similar to those for

blackout notices (i.e., in ERISA § 101(i)(2)(C)).

[10] The bill gives as examples fees charged to participants to cover administration, compliance, and recordkeeping costs, plan loan origination fees, possible redemption fees, and possible surrender charges.

[11] For this purpose, the term “charge” has the meaning above.

[12] In other words, the $1,000 per day penalty applies to the service provider if the plan administrator enters into a contact with a service provider without receiving the necessary disclosures.

[13] H.R. 1984 does not include a provision that was in H.R. 3185 that would have required the Department of Labor to engage in public outreach and make certain reports to Congress.
