

MEMO# 21760

October 5, 2007

Rep. Neal Introduces Defined Contribution Plan Disclosure Bill

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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
OPERATIONS COMMITTEE No. 27-07 RE: REP. NEAL INTRODUCES DEFINED CONTRIBUTION PLAN DISCLOSURE BILL

Representative Richard Neal (D-Ma) introduced the “Defined Contribution Plan Fee Transparency Act of 2007” (H.R. 3765) 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.

Participant Disclosures

The new 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 Disclosure

The bill would require that a plan administrator [\[1\]](#) provide to eligible employees, prior to initial investment, [\[2\]](#) 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.

A written description would be deemed to satisfy the requirement for each investment option if the explanation:

- Provides a general description of the investment option's investment objectives, risk and return characteristics, historic rates of return, and the name of the investment manager;
- States whether the option is actively or passively managed;
- States whether the alternative is designed to be a comprehensive, stand-alone investment for retirement;
- Describes annual asset-based fees that reduce the rate of return of the option, and if applicable, includes a statement that the fees of one or more alternatives pay for services other than investment management;
- Describes the annual fees and expenses for administration and recordkeeping that are deducted from or reduce the income of participants' accounts (unless reflected in the asset-based fees described above), and the method used to allocate these fees and expenses to participants' accounts;
- Describes the fees and expenses in connection with purchase or sale of the investment option;
- Alerts participants to the existence of fees and expenses associated with participant-initiated transactions and how to obtain additional information on these fees and expenses;
- Describes any other fees and expenses not reflected above; and
- Includes a statement that investments should be selected not only on the basis of fees but also based on other key factors (investment objective, level of risk, historic rate of return, and the participant's personal investment objective).

The bill requires affected participants be provided this enrollment disclosure again in advance of any change to the investment options available under the plan.

Annual Disclosure

The bill would require that participants receive an annual notice describing the investment options that the participant selected as of the last day of the plan year and the key characteristics of each option. The notice must be provided within 90 days following the end of the plan year.

An annual notice would be deemed to satisfy the requirements if the notice provides a description of:

- The asset classes that the participant is invested in and the percentage allocated to each asset class;
- The total fees and expenses for participant initiated transactions deducted from the participant's account;
- Any other fees and expenses for administration and recordkeeping deducted from the participant's account;
- For each investment option selected by the participant:
 - The percentage of the account invested in the option;
 - Whether the option is active or passively managed;
 - A general description of the risk and return characteristics of the option;
 - Annual asset-based fees which reduce the investment option's return, and any fees for purchase or sale that have been or may be deducted from the participant's account; and
 - Historic returns over the preceding 1-, 5- and 10-year period.

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 \$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.

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, and for the annual 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 annual notice is provided). The participant notices may be combined with any other plan communication, and may be provided using any new technologies that may be used for other notices required under Code Section 401(a). Treasury is directed to prescribe models for the participant notices.

Treasury is also required to issue regulations addressing the appropriate classification of fees and expenses and addressing the disclosure of fees and expenses in investment alternatives “that do not have explicit fees, including investment alternatives that provide a guaranteed rate of return.”

Effective Date

The participant disclosures would apply to plan years beginning on or after January 1, 2009.

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 and must be posted on any Intranet or Internet website maintained for the purpose of providing participants access to plan information.

Initial Disclosure to Plan Administrator

The bill would require that a service provider 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;
- A statement of the amount the service provider reasonably expects to pay under the contract to third-party service providers or intermediaries (and the identity of each); and
- A statement of the 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).

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. A service provider that does not separately price these components may reasonably allocate the fees and expenses among them.

Annual Disclosure to Plan Administrator

The bill would require that within 90 days of the end of each plan year, 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 services 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 \$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.

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.

Effective Date

The service provider disclosure rules would apply to arrangements entered into or materially modified on or after 90 days after enactment.

Comparison to H.R. 3185

The legislation introduced by Representative Neal follows related legislation (H.R. 3185) introduced by Representative George Miller in July 2007. [\[3\]](#) Although there are similarities in the specifics, H.R. 3765 generally requires less detailed disclosure, especially in the provisions for service provider disclosure. H.R. 3765 would not mandate that plans offer an index fund and would not create a new Advisory Council. H.R. 3185 would only amend ERISA and does not contain Internal Revenue Code excise tax provisions.

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[Attachment](#)

endnotes

[1] 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 who maintains the plan.

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

[3] For a description of H.R. 3185, see [Memorandum](#) to Pension Members No. 44-07, Federal Legislation Members No. 4-07, Bank, Trust and Recordkeeper Advisory Committee No. 25-07, Broker/Dealer Advisory Committee No. 43-07, and Operations Committee No. 19-07 [21396], dated July 27, 2007.

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