New Participant Fee Disclosure Rules:

What Plan Sponsors Need to Know

ExecutiveSummary

In October, the Department of Labor ("DOL") published final regulations that require plan administrators (typically the plan sponsor) to disclose certain fee and investment information to participants and beneficiaries in Employee Retirement Income Security Act of 1974 (ERISA) covered participant-directed individual account plans, which include the vast majority of 401(k) and private-sector 403(b) plans. The final regulations will apply to plan years beginning on or after November 1, 2011. Thus, for calendar-year plans, the regulations will become effective January 1, 2012.

The new participant disclosure rules are intended to help ensure that all participants and beneficiaries in participant-directed individual account plans have the information necessary to make informed decisions about plan participation and selection of investment choices for their accounts. Of course, recordkeeper and investment service providers to individual account plans have long helped plan sponsors make information about plan fees and investment-related expenses available to participants and beneficiaries, typically through a secure website. The new regulations, however, require plans to affirmatively provide specified information to "participants," defined broadly to include all individuals eligible to participate in the plan (without regard to whether an individual has an account balance).

For the most part, the information required to be disclosed under the regulations is not dissimilar from the information that is typically made available to participants and beneficiaries today, although the new regulations require disclosure of investment-related performance and fee information in a comparative format, which may differ from current practice. The new rules also create more uniform fee and performance disclosure requirements for different types of investment options, which may help plan sponsors as well as participants effectively compare investment alternatives.

Compliance should not be terribly burdensome for plan sponsors. Plan administrators should work with their recordkeeper to see that the necessary information is gathered and the required disclosures developed. Helpfully, plan sponsors are permitted to rely in good faith on information provided by their service providers, such as recordkeeper and investment providers, who will assist with providing the required information and developing the required disclosures.

The new rules may have broader repercussions. It is possible that the new rules and their comparative format requirement will indirectly affect covered individual account plans by helping to inform the number and types of investment alternatives that plans offer to participants. In addition, since the regulations highlight the manner in which plan administrative services are financed, they may influence plan sponsors' approach to financing plan costs.

By James M. Delaplane, Jr., for the Principal Financial Group®

Covered Plans and Participants

The final regulations apply to plan administrators of covered individual account plans, and the required disclosures that must be made to participants and beneficiaries.

A "covered individual account plan" is generally any participant-directed individual account plan subject to ERISA not merely those that elect to comply with ERISA section 404(c), which provides fiduciary relief for participant investment decisions if certain existing disclosure rules are satisfied. Employment-based Individual Retirement Accounts (IRAs) subject to ERISA – SEPs and SIMPLEs – are exempt from the regulations.

As noted above, "participant" is defined broadly, and includes any employee who is eligible to participate even if not actively participating. Thus, information must be given to eligible individuals who do not have account balances. Beneficiaries must be provided information to the extent that they, pursuant to the terms of the plan, have the right to direct investment of the assets held in (or contributed to) their accounts.

"Plan administrator" has the meaning given such term by ERISA, and generally means the person so designated in the plan document, or, if there is no such designation, the plan sponsor.

Two General Categories of Information Required to Be Disclosed

The information required to be disclosed to participants falls into two broad categories: 1) plan-related information; and 2) investment-related information.

Plan-related information

Plan sponsors must disclose the types of plan-related information described below.

- **Investment Direction.** Explanations must be provided regarding how participants and beneficiaries may give investment instructions, any limitations on such instructions under the plan, and plan provisions relating to the exercise of voting, tender, and similar rights. The plan's investment options must also be identified.
- **Plan-Level Administrative Expenses Charged Against Participant Accounts.** An explanation must be provided of plan-level administrative service expenses charged against participant accounts (e.g., annual per-participant fees) and how charges are allocated to participant accounts (e.g., per capita, pro rata). Disclosure is not required for charges against forfeiture accounts or for fees paid by employers.
- **Individual Expenses Charged Against Participant Accounts.** An explanation of fees that may be charged against participant accounts on an individual, rather than a plan-wide, basis (e.g., loan initiation fees, fees for use of brokerage windows, fees for investment advice programs) must be provided.
- **Quarterly Disclosure of Amounts Deducted from Participant Accounts.** At least quarterly, the plan sponsor must disclose the dollar amount of fees and expenses that are actually charged during the preceding quarter to the participant's account and must describe the services to which the charges relate (e.g., plan administrative services, individual transactions, such as loans, etc.). Plan administrative service charges not included in the annual operating expenses of plan investments would typically be disclosed here. The charges must be disclosed in dollars even if the charges are assessed as a percentage of plan assets, for example, a wrap fee charged by an RIA and paid through the sale of shares. However, plan administrative service charges need not be disclosed on a quarterly basis if the charges are paid from investment options, i.e., other than through the sale of shares. In this instance, where plan administrative expenses are paid from the total annual operating expenses of one or more plan investments (e.g., through 12b-1 fees), the quarterly disclosure must also include a statement (not numbers) that such payments are in addition to any plan-level administrative service charges set forth in the quarterly disclosure. Given the prevalence of financing plan administrative services from investment operating expenses, the vast majority of plan sponsors will need to include this statement in the quarterly disclosures. The quarterly disclosure may be done through confirmations of transactions or included on quarterly benefit statements.

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DOL has provided a safe harbor model chart for use in meeting this comparative format requirement, which can be viewed at www.dol.gov/ebsa/participantfeerulemodelchart.doc.

Fees will typically be disclosed in the same way the fees are calculated, for example, as formulas, basis points, or hard dollars. The only charges that must be disclosed in dollars are amounts deducted from participant accounts, including charges financed through the sale of shares.

Comparative performance and fee information on plan Investment options

Certain types of performance and fee information on plan investment options must be disclosed in a comparative format to help participants make an apples-to-apples comparison across the menu. DOL has provided a safe harbor model chart for use in meeting this comparative format requirement, which can be viewed at *www.dol.gov/ebsa/participantfeerulemodelchart.doc*. Please note that the linked chart is simply a model, and the chart that The Principal® provides to its plan sponsors may differ in appearance.

The model chart has three parts. The **first section** lists historic performance-related information for each of the plan's designated investment alternatives; the **second** lists fee and expense information for each alternative. In turn, to facilitate an apples-to-apples comparison, the performance-related section and the fee section are divided between investment options that provide a non-fixed rate of return, e.g., mutual funds, and options that provide a fixed rate of return. A **third section** would be used to disclose information related to any annuity features of the plan.

The chart must contain the following **performance-related** information on plan investments:

- **Identifying Information.** Identifying information must be provided for each investment under the plan, including the name and category of the investment (e.g., money market fund, balanced fund, large cap stock fund). DOL expects that plan sponsors will typically rely on the categorization supplied by the investment service provider.
- **Performance Data.** For investments without fixed returns, the chart must include the average annual total return of the investment for the 1-, 5-, and 10-calendar year periods (or for the life of the alternative, if shorter), as well as a statement indicating that past performance is not necessarily an indication of future performance.

SAFE HARBOR MODEL	
The model chart for use in meeting the comparative format requirement has three parts:	
1.	Historic performance-related information
2.	Fee and expense information
3.	Annuity feature information

Example of performance-related information

VARIABLE RETURN INVESTMENTS				
Name/Type of Option	Average Annual Total Return as of 12/31/XX			
	1 year	5 year	10 year	Since Inception
A Index Fund	**0.0%**	**0.0%**	**0.0%**	**0.0%**
Benchmark	0.0%	0.0%	0.0%	0.0%
B Index Fund	**0.0%**	**0.0%**	**0.0%**	**0.0%**
Benchmark	0.0%	0.0%	0.0%	0.0%

For investments with fixed/stated rates of return, such as guaranteed investment contracts ("GICs") or fixed account investments, the rate of return and the term of the investment must be provided, as well as a description of the extent to which the issuer reserves the right to change the rate of return prospectively.

- **Benchmark Comparison.** The plan sponsor must provide the name and returns of a benchmark broad-based securities market index over the corresponding 1-, 5-, and 10-year periods. Plan sponsors are permitted to display the returns of a second "blended" benchmark for blended investment offerings such as balanced or target date funds. The benchmarking requirement does not apply to funds with a fixed rate of return.

The chart must contain the following **fee-related** information on plan investments:

- **Shareholder-Type Fees.** The chart must include the amount and a description of fees charged directly against a participant's or beneficiary's investment (e.g., sales loads, redemption fees, surrender charges) and restrictions applicable to purchase, transfer, or withdrawal of the investment.
- **Annual Operating Expenses.** The chart must provide the total annual operating expenses of the investment expressed as a percentage (e.g., expense ratio). However, the chart must also include an example that translates these percentage charges into dollars and cents on an illustrative $1,000 investment. There is no requirement to disclose the extent to which the total annual operating expense of the investment defrays the cost of plan administrative or other plan services. As noted above, the plan sponsor must only provide a quarterly statement, when applicable, indicating that some of the plan's administrative expenses for the preceding quarter were paid from the total annual operating expenses of one or more plan investment. The regulations also provide rules for calculating the total annual operating expenses for non-mutual fund investments, such as collective investment funds, to facilitate ease of comparison for participants.

- **Required Statements.** The chart must include statements that (i) fees and expenses are only one of several factors to consider when making investment decisions, (ii) cumulative fees and expenses can substantially reduce retirement account growth, and (iii) participants and beneficiaries can visit the DOL website for an example demonstrating the long-term effect of fees and expenses on account growth.

For an investment with a fixed rate of return, in lieu of the fee and expense information specified above, the plan sponsor must provide the amount and a description of shareholder-type fees and a description of any restriction or limitation that may be applicable to a purchase or sale of the fixed investment.

Providing disclosures regarding plan investments in the sort of comparative format contemplated by the regulations ordinarily will not present a challenge. However, some 403(b) plans do not utilize a single recordkeeping firm/platform provider and offer investments directly from more than one vendor. The preamble to the new rules notes that in cases such as this each service provider may develop its own chart but that all of the charts will need to be provided together to participants. As a result, employers with multi-vendor 403(b) plans may need to take a more active role in ensuring compliance with the new rules, for example, by serving as an aggregator of service provider charts.

Customized Disclosures for Certain Investment Alternatives

As seen with fixed products, the new regulations contain special disclosure rules that apply to certain types of investment alternatives. These special provisions may expand upon or limit application of the general disclosure rules.

- **Brokerage Windows.** Plan sponsors do not need to disclose performance or fee information on the investments participants can reach through brokerage windows. However, a plan must disclose the costs associated with utilizing a brokerage window and then report these dollar charges in the subsequent quarter.
- **Target Date Funds ("TDFs").** The final regulations did not include special disclosure rules for TDFs but reserved a section for such rules. DOL has since released proposed regulations filling in this section and requiring specialized disclosures for TDFs, including disclosure of the fund's asset allocation, the fund's glide path (with an illustration), the relevance of the target date, and the potential of TDFs to lose money. This information should be included as an appendix to the chart.

- **Annuities.** Special rules apply to investment options that offer participants a current or future ability to translate their savings into annuitized lifetime income. These rules generally require disclosures that focus on the factors that determine the guaranteed income amount and the fact that such guarantees are subject to the financial strength of the insurer.
- **Company Stock.** A number of the performance and fee disclosure requirements in the final regulations do not apply to company stock funds. In this regard, the final regulations differentiate between unitized and non-unitized company stock funds, requiring different disclosures for each. It should be noted that the regulations do specify a method for calculating average annual total return for non-unitized funds (in which participants own shares of stock directly). This method must be used when disclosing performance over the 1-, 5-, and 10-year periods (or for the life of the alternative, if shorter).

Websites must be provided for all investment alternatives

Each investment must have an internet website containing additional detailed investment information. The website will include, for example, information about an investment's objectives, portfolio turnover rate, and principal strategies and principal risks. The address of each website must be listed on the chart, and information on the website must also be available to participants in paper form upon request. These websites will almost invariably be maintained by issuers of the plan's investments. Plan sponsors must also provide participants with a glossary of investment terms, either directly or by providing a website address where the glossary can be found.

Additional investment-related disclosures must be provided upon request

Certain other information must be provided upon request, including prospectuses, financial statements or reports, statements of share value, and a list of the assets in non-mutual fund investments.

Affirmative disclosure required

Today, much of the information on plan fees and investments is simply made available to participants, often through on-line resources. The regulations, however, generally require affirmative disclosure of the required information. It will not be enough merely to make the information available on-line.

Generally, required disclosures must be made on or before the date on which the participant or beneficiary can make investment elections, and at least annually thereafter.

Electronic delivery

The regulations are not as supportive as had been hoped in terms of being able to use electronic means to make these affirmative disclosures. Under the rules, paper copies will be required unless participants consent to electronic delivery or use a computer as an integral part of work. However, DOL has announced its intention to revisit its current rules. It is hoped that new rules will facilitate the use of electronic delivery methods and therefore reduce the costs associated with the new disclosures.

Timing of disclosure

Generally, required disclosures must be made on or before the date on which the participant or beneficiary can first make investment elections, and at least annually thereafter. This pre-investment direction requirement may be satisfied by furnishing the most recent annual disclosure and any updates. A transition rule allows the required disclosures to be made to existing participants and eligible employees within 60 days of the regulations becoming applicable (which is March 1, 2012 for calendar-year plans).

Updates regarding **plan-related** information must be disclosed at least 30 days, but not more than 90 days, prior to the effective date of the change, unless disclosure is precluded due to unforeseeability or circumstances beyond the control of the plan, in which case notice must be furnished as soon as reasonably practicable. This updating requirement does not apply to changes in **investment-related** information. However, such changes must be reflected in the next annual notice and information should be updated on the investment website as soon as reasonably possible following a change.

As discussed above, account charges must be disclosed on a quarterly basis as a dollar amount.

Failure repercussions

The new rules create a general fiduciary obligation to disclose the required information about plan investments and fees to participants and beneficiaries. There are no specific dollar penalties for failure to comply; rather, at most, a failure to provide the required information seems to be a breach of fiduciary duty. A breach of fiduciary duty can give rise to DOL or plan participants asserting a right to equitable remedies.

The disclosure obligations in the regulations are technically imposed on the plan administrator. As mentioned above, however, a plan administrator will not be liable for the completeness and accuracy of information used to satisfy the disclosure requirements if it reasonably and in good faith relies on information received from a service provider or an issuer of an investment alternative. Recordkeepers, including The Principal, will ordinarily be able to provide the necessary information for investment options made available through their platform. Occasionally, however, a plan may offer an investment which is not part of the recordkeeper's platform, for example, an investment that carried over from a prior service provider, in which case the employer may need to work with the investment providers to ensure that the requisite information is compiled and made available.

The regulation is silent on what plan administrators' precise fee and investment disclosure obligations were in years preceding the effective date of the regulations, but the preamble to the new rules notes that plans that satisfied the 404(c) disclosure requirements typically will have satisfied their disclosure requirements for past periods.

Repercussions and Next Steps

As noted, the final rules will change the disclosures currently made to participants and beneficiaries in a number of ways. One difference from current practice is the requirement to reach out annually to eligible employees not yet participating in the plan with detailed information about the plan, plan fees and plan investment options. While an operational headache, this may provide another resource to help spur plan participation among this group. Another difference is that affirmative disclosures will be required; the requisite information may no longer merely be made accessible to participants. This requirement will probably have the greatest impact on investment-related information, which is often currently made available via a secure website rather than provided affirmatively. A further difference is that investment-related information will be required to be disclosed in a comparative format, which will probably elevate participant reliance on the performance and fee information featured on the chart in making their investment elections. Finally, when coupled with the affirmative disclosure requirement, the quarterly disclosure in dollars of participant account charges could make participants more sensitive to the costs of certain plan services and prompt new questions about plan administrative charges that appear in these quarterly disclosures.

Beyond these compliance obligations, there may be other potential repercussions from providing the new required fee and investment disclosures to participants.

Overall, the new disclosure requirements should not result in a significant new compliance burden for plan sponsors. Yes, this is one more in the laundry list of participant notices that sponsors must prepare or coordinate, and that will generate some additional work. But much of the information to be included in the participant fee and investment disclosures will come from investment and other service providers. Recordkeepers like The Principal will be working with sponsors to gather this information and develop a comparative chart and other required disclosures to help the plan sponsor meet their requirements. Plan sponsors should work to ensure that all its plan providers are working together to assemble the required information on plan investments. Plan sponsors will need to devote particular attention to collaborating with recordkeepers to ensure proper compilation, disclosure and updating of plan-related information and to establish a system for reaching eligible employees who are not yet participating in the plan.

Beyond these compliance obligations, there may be other potential repercussions from providing the new required fee and investment disclosures to participants. The requirement to display performance and fee information on plan investment options in a comparative format may prompt sponsor discussions both about the size of the investment menu and the specific investment offerings. Large menus may give rise to unwieldy comparative charts that are difficult for participants to digest, raising the issue of whether to consider a reduction in plan investment offerings. The specific disclosure regimes for certain types of investments, such as fixed products, may prompt sponsors to evaluate these options seriously for the first time. Similarly, the new, more specific requirements to disclose how plan administrative costs are financed may lead to an evaluation of the plan's financing approach, particularly the current mix of distinct administrative charges versus use of plan investment operating expenses to finance plan administrative services. In particular, the quarterly dollar disclosure requirement for participant account charges may raise participant sensitivities about financing administrative services through dollar charges or sales of shares rather than from investment operating expenses. If these new regulations do prompt discussions at your company about plan investment menus and about plan costs and the best method to finance them, The Principal and the financial professionals with whom it works stand ready to work with you to develop flexible alternatives that will meet your specific objectives.

ABOUT THE AUTHOR

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Since joining Davis & Harman LLP as a partner in 2002, Jamey has represented a broad range of financial institutions, employers, and public policy organizations on employee benefits, tax, and financial services matters before the U.S. Congress and the federal executive branch agencies. A retirement and savings policy specialist, Jamey devotes particular time to legislation and regulation affecting defined benefit and defined contribution plans, IRAs, and 529 college savings plans. Jamey coordinates a number of employer coalitions, including one focused on hybrid defined benefit plan policy and one focused on the tax treatment of domestic partner health benefits. He is a frequent keynote speaker at national retirement industry conferences who is sought after to provide insight regarding what Washington developments will mean for retirement plan sponsors and service providers.

From 1998 to 2002, Jamey was Vice President, Retirement Policy for the American Benefits Council (ABC), which is the national association representing the employee benefits interests of major U.S. employers. At ABC, Jamey oversaw the development of policy concerning retirement, equity compensation, and investment issues and served as chief lobbyist and media spokesperson on those issues. While at ABC, he helped lead the coalition that pushed for enactment of the pension and retirement savings provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and worked extensively on cash balance plan issues with Congress and the federal regulatory agencies. He now serves as Special Counsel to ABC and has testified before Congress on its behalf.

Jamey worked as legislative counsel to U.S. Representative Earl Pomeroy (D-North Dakota) from 1996 to 1998, where he was the chief staff person on retirement, health, and related tax matters. He was instrumental in helping Representative Pomeroy draft and advance the Retirement Account Portability Act, many of the provisions of which became law in 2001 as part of EGTRRA. During the summer of 1997, Jamey was detailed to the Pension Benefit Guaranty Corporation, where he served as the key transition aide to the incoming Executive Director.

Jamey's legal and policy work has been widely recognized. He has been named by *401kWire* as one of the 100 most influential people in the defined contribution plan industry for five years running (2007-2011). In 2002, *Business Insurance* named him one of 35 "Rising Stars" in the commercial insurance and benefits management industry. In 1998, *Pensions & Investments* recognized him as one of the "25 People to Watch" in the pension and investment community—the only federal government official among those named.

Jamey earned his B.A. and J.D., both *cum laude*, from Harvard University, and was an editor of the *Journal on Legislation* during law school.

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