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*Fee Disclosure in Defined Contribution Retirement Plans:
Background and Current Legislation*

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September 22, 2008

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CRS Report for Congress

Fee Disclosure in Defined Contribution Retirement Plans: Background and Current Legislation

September 22, 2008

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Prepared for Members and
Committees of Congress

Fee Disclosure in Defined Contribution Retirement Plans: Background and Current Legislation

Summary

As households become more reliant on 401(k) plans and other defined contribution pension plans for future retirement income, policymakers have become more concerned that participants could be unaware of the fees charged in their plans. Small differences in fees charged can have large impacts on account balances upon retirement. This report provides information on the kinds of fees that are charged in 401(k) and other defined contribution plans and details the provisions of three bills that address fee disclosure in retirement plans: H.R. 3185, the 401(k) Fair Disclosure for Retirement Security Act, which was approved by the Committee on Education and Labor by a vote of 25-19 on April 16, 2008; H.R. 3765, the Defined Contribution Plan Fee Transparency Act of 2007, introduced on October 4, 2007; and S. 2473, the Defined Contribution Fee Disclosure Act of 2007, introduced December 13, 2007.

This report will be updated as legislative action warrants.

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Fee Disclosure in Defined Contribution Retirement Plans: Background and Current Legislation

Background on 401(k) Fees

The Structure of 401(k) Plans and the Impact of Fees

Defined contribution (DC) plans are employer-sponsored retirement plans in which employees and/or employers contribute to an individual employee's account that accrues investment returns.¹ Upon retirement, employees use the accounts as a source of income. DC plans may be "qualified" if they meet certain Internal Revenue Service (IRS) guidelines with respect to pension plan contributions, benefits, and distributions. 401(k) plans are qualified plans that include a cash or deferred arrangement under which participants can choose to contribute part of their before-tax compensation to the plan rather than receive the compensation in cash.² The tax code allows employees to contribute a pre-tax maximum of \$15,500 in 2008 to their individual 401(k) accounts. Although there are other kinds of DC account plans in addition to 401(k) plans (such as 457 plans for employees of state or local governments and 403(b) plans for educational institutions and other tax-exempt organizations), these plans operate similarly to 401(k) plans, and the term 401(k) plan often refers to these other plans as well.³ Unless specifically stated, the term 401(k) plan in this report also refers to these other plans.

The percentage of employees covered by DC plans has been increasing in recent years. According to the National Compensation Survey from the Bureau of Labor Statistics, 36% of all workers participated in a DC plan in 1999. This percentage increased to 43% by 2006. DC plans will continue to play an important role in Americans' retirement security.

There has been a growing interest in the fees that participants in 401(k) plans are charged. Small differences in fees can yield large differences in account balances

¹ A defined contribution plan is defined in 26 U.S.C. § 414(i) as "a plan which provides for an individual account for each participant and for benefits based solely on the amount contributed to the participant's account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account."

² The names for the various types of defined contribution retirement plans are often the section of the Internal Revenue Code that authorizes these plans (e.g., 26 U.S.C. 401(k) or 26 U.S.C. 457(b)).

³ See 26 U.S.C. § 402(g)(1).

at retirement, especially in the case of yearly or recurring fees.⁴ For example, **Table 1** shows the effect that a 0.5%, a 1.0%, and a 1.5% annual fee would have on an initial \$20,000 account balance that earns 7% yearly. After 20 years, the account would have about \$77,000 if no fee is charged, whereas the account would have about \$70,000 if a 0.5% fee is charged. The account would have a balance of about \$58,000 if a 1.5% fee is charged (17% less than the account that charged a 0.5% fee). If a 1.5% annual fee is charged, over the course of 30 years an account holder would pay more than \$52,000 in fees. The complexity of 401(k) plan arrangements may provide opportunities for fees to be higher than they otherwise might be, particularly if plan sponsors and participants are not fully informed of the fees they pay. Policies that increase the transparency of fee arrangements may result in participants paying lower fees.

**Table 1. Effect of Annual Fees on a \$20,000 Balance
(Assuming 7% Annual Real Rate of Return)**
(amount in \$)

Account Balance	Annual Fee			
	None	0.5%	1.0%	1.5%
After 20 years	7,394	70,473	64,143	58,355
After 30 years	152,245	132,287	114,870	99,679

Source: CRS calculations.

Note: The average annual real rate of return on the Standard & Poor's 500 Stock Market Index from 1926 to 2007 was 6.99%.

Under the Employee Retirement Income Security Act (ERISA, P.L. 93-406), plan sponsors have a fiduciary responsibility to plan participants; that is, they must carry out their responsibilities prudently and solely in the interest of the plan's participants.⁵ Among other duties, fiduciaries have a responsibility in ERISA to defray reasonable expenses of administering the plan, but there are limited fee disclosure requirements to plan participants.⁶

Structure of 401(k) Plans

Figure 1 details the structure of a typical 401(k) plan, although particular plans may have slightly different structures. Fee arrangements affect three groups in 401(k) plans: (1) plan participants, (2) plan sponsors and plan administrators, and (3) service providers. The plan participants are the employees of the company who have individual accounts to which the employees, the employer, or both contribute.

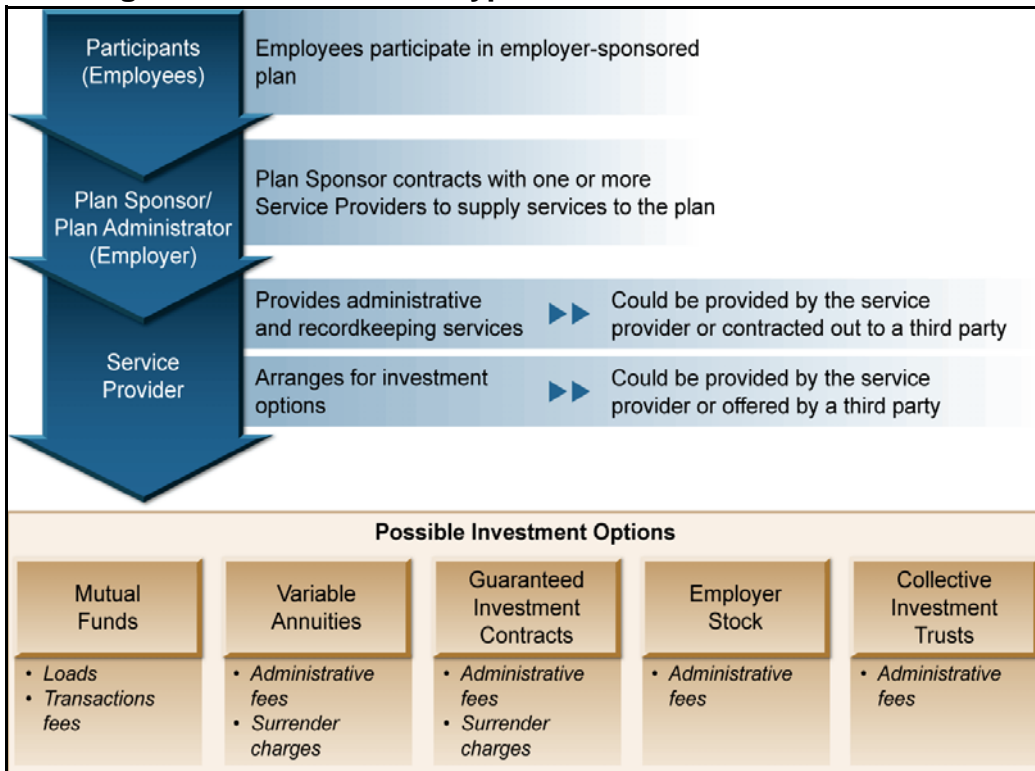
⁴ For a detailed analysis of the effects that fees have on account balances, see CRS Report RL34213, *Retirement Savings Accounts: Fees, Expenses, and Account Balances*, by Patrick Purcell.

⁵ For more information, see CRS Report RL34443, *Summary of the Employee Retirement Income Security Act (ERISA)*, by Patrick Purcell and Jennifer Staman.

⁶ See 29 U.S.C. § 1104(a)(1)(A)(ii).

As the plan sponsor, the employer arranges for one or more service providers to provide various services for the plan. Prior to choosing a service provider, plan sponsors might ask several providers for details on the products they offer and the fees they charge. Service providers provide a number of services for plan sponsors and participants including the day-to-day plan business such as recording transactions, arranging for loans, cashing out retirees' accounts, and arranging for investment options. Most service providers offer several mutual funds to the retirement plan and may offer other investment options as well, including insurance company offerings such as variable annuities and bank or trust company pooled investment trusts.

Figure 1. Structure of a Typical Defined Contribution Plan



Source: CRS.

Employers could purchase these services separately from individual service providers or employers could purchase two or more services from a single service provider in a *bundled* arrangement. In a bundled arrangement, a service provider offers several services or investment alternatives to the plan for a single fee. The service provider may contract out the provision of these services to one or more third parties. Current law does not require the services in bundled arrangements to be priced separately. The Department of Labor (DOL) has issued regulations to require service providers to identify all parties who receive payments of more than \$5,000 from the plan.⁷

⁷ See Department of Labor, "Annual Reporting and Disclosure," 72 Federal Register 221, November 16, 2007, pp. 64710-64730.

The terms “plan sponsor” and “plan administrator” are often used interchangeably, although they need not be the same entity. A plan sponsor is an employer that establishes a retirement plan. The plan administrator is responsible for the day to day running of the plan. The plan administrator may be the employer, a committee of employees, a company executive, or someone hired for that purpose. The plan administrator is defined in 26 U.S.C. § 414(g) as the person specifically so designated by the terms of the plan or the employer in the absence of such a designation. To avoid confusion, this report’s use of the term “plan sponsor” includes “plan administrator.”

In most DC plans, participants have control over some or all of the assets in their individual accounts, although this control is limited to the investment options made available by the service providers. Less common are plans in which the participants have no control over the assets. Current proposals in Congress would require plan sponsors of all DC plans to receive fee disclosures from service providers, but only participants in plans in which the participants exercise control over the assets would receive fee disclosures from plan sponsors. **Table 2** indicates that 401(k) plans where the employee has control over all or a portion of the assets in the plan accounted for 88.8% of all DC plans in 2005. Two of the proposals in Congress (H.R. 3185 and S. 2473) would provide assistance to small employers (employers with less than 100 employees) by providing educational and compliance materials to small employers and by providing assistance with finding and understanding affordable investment options. **Table 2** indicates that 13.9% of plan participants are in plans in which there are fewer than 100 participants.

Types of 401(k) Fees

The Employee Benefits Security Administration (EBSA) is an agency within the Department of Labor (DOL). It is charged with protecting the integrity of employee benefits, including retirement plans. An EBSA publication, *A Look At 401(k) Plan Fees*, describes three types of fees: plan administration fees, investment-related fees, and individual service fees.⁸ According to EBSA, investment-related fees are the largest component of 401(k) plan fees.

Plan Administration Fees. These are fees for the day-to-day operations of plans such as record keeping, accounting, legal, and trustee services. Additional services might also be provided, such as access to customer service representatives, educational seminars, or daily valuation. The amount charged for administrative fees can vary depending on the quantity and quality of the services offered. For example, service providers that offer website access with extensive online services might charge higher fees than service providers that provide only basic website services. Administrative fees may be charged either as a flat fee per participant or as a percentage of plan assets.

⁸ Available at [<http://www.dol.gov/ebsa/pdf/401kFeesEmployee.pdf>].

Table 2. Number of Defined Contribution Plans and Participants, by Size of Plan and Extent of Participant Direction of Investments, 2005

		All Plans	Plans With 2 - 99 Participants	Plans with 100 or More Participants
All Plans	Number of Plans	421,776	362,482	59,294
	Number of Participants (in thousands)	54,623	7,573	47,050
Participant Directs All Investments	Number of Plans	354,849	300,435	54,414
	Number of Participants (in thousands)	43,223	6,592	36,631
Participant Directs Portion of Assets	Number of Plans	19,825	17,230	2,595
	Number of Participants (in thousands)	8,480	337	8,143
Participant Does Not Direct Any Investments	Number of Plans	47,099	44,816	2,283
	Number of Participants (in thousands)	2,921	646	2,275

Source: U.S. Department of Labor, Table D-6 of Private Pension Plan Bulletin, Abstract of 2005 Form 5500 Annual Reports.

Notes: Table does not include plans that did not report the number of participants. Employers may have multiple plans. Employees may be in multiple plans and are counted in each plan in which they participate. The small discrepancies in the totals for each column are found in the original source.

Investment Fees. Investment fees cover the costs of transactions within investment options, such as the trades a particular mutual fund makes. Some investment fees include the following.

- **Sales Charges:** These are also known as loads. A front-end load is charged upon investing in some mutual funds. Front-end loads reduce the amount of the initial investment. Back-end loads (also called deferred sales charges or redemption fees) are charged upon selling mutual funds.
- **Marketing and Distribution Fees:** These are called “Rule 12b-1” fees after the 1980 Securities and Exchange Commission’s (SEC) rule that allowed mutual funds to charge for marketing and

distribution of mutual fund shares.⁹ Rule 12b-1 fees are annual fees that may be charged by mutual funds from fund assets to pay for promotional costs and commissions to brokers and other salespeople. A point of contention is that service providers may receive 12b-1 fees for including particular mutual funds as investment options for participants in the plans they administer. Although the SEC does not limit the amount of 12b-1 fees, under the Financial Industry Regulatory Authority (FINRA) rules, 12b-1 fees that are used to pay marketing and distribution expenses (as opposed to shareholder service expenses) cannot exceed 0.75% of a fund's average net assets per year.

- **Soft Dollar Fees:** These payments are for brokerage firm services (such as research) other than commissions for trade execution.
- **Surrender and Transfer Charges:** These are fees that insurance companies may charge when employers withdraw from variable annuities before the contract expires.
- **Wrap Fee:** Wrap fees are “all-in-one” fees that combine asset management, financial planning, and brokerage services together for one fee.

Individual Service Fees. Individuals are charged fees that are associated with using optional features in a 401(k) plan, such as loan origination fees and fees for hardship withdrawals.

Documents Required by Current Law

Three documents required by current law contain information about potential fees: Summary Plan Descriptions (SPDs), Summary Annual Reports, and Account statements.

Summary Plan Descriptions. SPDs describe how plans operate.¹⁰ Plan sponsors are required to automatically provide copies of these documents to plan participants upon enrollment and upon written request of plan participants. Among other items, SPDs contain information about eligibility and vesting requirements, plan benefits, and the source of contributions. SPDs are required to disclose a summary of provisions that may result in a fee charged to a participant, the payment of which is a condition to the receipt of benefits under the plan. An EBSA Field

⁹ Prior to the adoption of Rule 12b-1, the SEC generally took the view that section 12b-1 of the Investment Companies Act of 1940 (15 U.S.C. § § 80a-1 - 80a-64) prohibited mutual funds from using fund assets to pay for the sale of their shares.

¹⁰ See 29 CFR § 2520.103-2 and 29 CFR § 2520.103-3 for regulations concerning the style and contents of SPDs.

Assistance Bulletin notes that charges for hardship withdrawals, if a plan allows hardship withdrawals, might be an example of such a charge.¹¹

Plans must also make a Summary of Material Modifications available within seven months of the end of the plan year in which significant changes to the plan were made.

Annual Report Form 5500. The Form 5500 was jointly developed by DOL, the IRS, and the Pension Benefit Guaranty Corporation (PBGC) and is required to be submitted annually by ERISA-covered plans. This annual report contains various schedules with information on the financial condition, investments, and operations of the plans. On November 16, 2007, EBSA issued regulations to revise the Form 5500. Among other requirements, the regulations require administrators and sponsors of plans with more than 100 participants to disclose the identity of service providers who receive direct or indirect compensation of \$5,000 or greater in connection with services rendered to the plan.¹² The types of compensation include 12b-1 fees, brokerage commissions, and soft dollars. A plan's annual report may be available from the employer upon request and is available from DOL in the EBSA Public Disclosure Facility.

Benefit Statements. Section 508 of the Pension Protection Act of 2006 (P.L. 109-280) requires plan sponsors to provide participants in DC plans with quarterly benefit statements if the investments are participant-directed and annual statements if the investments are not participant-directed. The quarterly benefit statement must include the value of each investment in the individual's account, an explanation of any limitations or restrictions on any right of the participant or beneficiary under the plan to direct an investment, and an explanation of the importance of a well-balanced and diversified investment portfolio for long-term retirement security. On July 23, 2008, DOL issued proposed regulations that would require plan fiduciaries to disclose to participants, on a quarterly basis, the actual dollar amount charged to the participant's account during the preceding quarter for individual services (such as fees for processing plan loans).¹³

Fee Disclosure Legislation in the 110th Congress

Three bills have been introduced in the 110th Congress to address the expenses and fees charged in 401(k) and other DC plans. The bills would require service providers to disclose to plan sponsors the services to be provided to the plan and the expected fees and expenses. The disclosures would be made prior to entering into a contract for services to a plan and upon any material changes to the contract for services. The bills would also require plan sponsors to disclose to a participant the

¹¹ See Field Assistance Bulletin 2003-3 issued by EBSA on May 19, 2003.

¹² See Department of Labor, "Annual Reporting and Disclosure," 72 *Federal Register* 221, November 16, 2007, pp. 64710-64857.

¹³ See Department of Labor, "Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans," 73 *Federal Register* 142, July 23, 2008, pp. 43013-43044.

expected fees and expenses associated with the plan and the plan's investment options. This disclosure would be made prior to any initial contribution by a participant. Plan sponsors would also have to provide, on a regular basis, each participant with details of the fees and expenses the participant incurred over a specified period.

The following paragraphs summarize the bills. Following the summaries, the report describes the bills' details in the following categories: (1) disclosures from service providers to plan sponsors, (2) disclosures from plan sponsors to plan participants, (3) a minimum investment option, (4) assistance to small employers, (5) enforcement and review, and (6) imposition of taxes.

Bill Summaries

H.R. 3185 and S. 2473. Representative George Miller introduced H.R. 3185, the 401(k) Fair Disclosure for Retirement Security Act of 2007 on July 14, 2007, and the House Committee on Education and Labor passed this bill by a vote of 25-19 on April 16, 2008. Senator Tom Harkin introduced S. 2473, the Defined Contribution Fee Disclosure Act of 2007, on December 13, 2007. H.R. 3185 and S. 2473 are similar in many respects.

The bills would amend ERISA and would require

- service providers to disclose more information on the fees associated with a particular 401(k) plan to plan sponsors and any relationships that service providers have with entities providing services to a 401(k) plan;
- plan sponsors to inform 401(k) participants about their investment options and the kinds and amounts of fees associated with the investment options;
- plan sponsors to provide each participant in a 401(k) plan with a detailed breakdown of the fees a participant paid in each quarter; and
- the Secretary of Labor to provide sample notices of the required documents; to widely disseminate the identity of service providers found to preclude compliance by plan sponsors; and to audit a representative sampling of 401(k) plans to determine compliance with the provisions of the bill. The Congressional Budget Office estimates that these provisions would increase government spending by \$3 million over FY2009-FY2013.¹⁴

Minimum Investment Option Requirement in H.R. 3185. H.R. 3185 has an additional requirement that is not found in S. 2473 or H.R. 3765. H.R. 3185

¹⁴ Congressional Budget Office cost estimate, H.R. 3185: 401(k) Fair Disclosure for Retirement Security Act of 2008, available at [<http://www.cbo.gov/ftpdocs/93xx/doc9323/hr3185.pdf>].

would require each 401(k) plan to include at least one investment option that is a broad-based market index fund (or combination of funds) that would likely meet retirement income needs at adequate levels of contributions. 401(k) plans that do not include such an option would lose their protection against liability from participants' investment losses under ERISA § 404(c).

H.R. 3765. Representative Richard Neal introduced H.R. 3765, the Defined Contribution Plan Fee Transparency Act of 2007, on October 4, 2007.

This bill would impose taxes on service providers and plan sponsors that failed to meet the requirements of the bill. The bill would amend the Internal Revenue Code and would require

- plan sponsors to provide participants with disclosures of fees and expenses prior to making investments in the plan;
- plan sponsors to provide each participant in the plan an annual notice of the fees paid by the participant's account; and
- service providers to disclose to plan sponsors fee information and any third-party relationships that service providers might have.

Details of 401(k) Fee Legislation

Disclosure from Service Providers to Plan sponsors. All three bills would require service providers to supply plan sponsors with a written statement detailing the services to be provided under the contract and an estimate of the expected total fees and expenses or charges expected under the contract.

Timing of Disclosure. H.R. 3185 would require that plan administrators of individual account plans receive a Service Disclosure Statement from 401(k) plan service providers at least 10 business days prior to entering into any contract for services to the plan if the contract equals or exceeds \$5,000. This amount would be adjusted for inflation beginning in 2010.

S. 2473 would require service providers to provide fee information to plan sponsors of 401(k) and 403(b) plans reasonably in advance of entering into a contract for plan services. The law would apply to any contract greater than \$5,000 or 0.01% of the value of plan assets as of the last day of the preceding plan year.

H.R. 3765 would require service providers to provide an "initial disclosure" statement prior to entering into or materially modifying a contract for the provision of plan services.

Kinds of Pension Plans. The provisions in H.R. 3185 and S. 2473 requiring disclosure from service providers to plan sponsors would apply to "individual

account plans.”¹⁵ The provisions in H.R. 3765 would apply to “applicable defined contribution plans.” Both definitions include 401(k) plans, 403(a) plans, and 457(b) plans.¹⁶

Bundled Service Charges. The bills would require service providers to report the fees and expenses within several categories.

H.R. 3185 would require the allocation of fees to four component charges: (1) plan administration and record keeping; (2) transaction-based charges; (3) investment management; and (4) all other charges as may be specified by the Secretary of the Treasury.

S. 2473 would require the allocation of fees to four component charges: (1) charges for investment management; (2) charges for record keeping and administration; (3) sales charges, including commissions, and charges for advisory services; and (4) any other charges.

H.R. 3765 would require an estimate of the total fees and expenses expected under the plan and the itemization of (1) annual fees and expenses for investment management and (2) annual fees for administration and record keeping.

Form of Charges and Permission of Estimates. The bills require some fees to be reported as dollar amounts and other fees to be reported as percentages of assets. The bills would allow service providers to report fees as estimates where the actual amounts of the fees are unknown.

In H.R. 3185, plan administration and record keeping and investment management charges would be presented as aggregate dollar amounts. Transaction-based charges may be presented as percentages of applicable base amounts. Reasonable and representative estimates of the charges are permitted, provided the statement indicates the charge as being an estimate and provided the estimate is based on the previous year’s experience.

S. 2473 would allow each charge to be expressed as either a dollar amount or as percentage of assets. The form of such charges would have to be consistent throughout the statement. In cases where services are bundled or the costs are unknown, S. 2473 would require service providers to provide reasonable and representative estimates of charges.

¹⁵ The term *individual account plan* or *defined contribution plan* is defined in 29 U.S.C. 1002(34) as “a pension plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant’s account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant’s account.”

¹⁶ Specifically, H.R. 3765 applies to defined contribution plans described in 26 U.S.C. 402(c)(8)(B)(iii)-(vi): qualified trusts (such as 401(k) plans), 403(a) plans, 457(b) plans, and 403(b) plans.

H.R. 3765 would allow the fees and expenses to be expressed as either a dollar amount or as a percentage of assets (or a combination thereof). H.R. 3765 would allow reasonable estimates of fees and expenses if the service provider does not separately price such services and if the service provider discloses the basis for such estimates.

Third Party Payments. The bills would require disclosure of relationships that service providers have with third parties who provide services to plans.

H.R. 3185 would require disclosure of any payments that the service provider receives from any person providing services to the plan. It would also require the disclosure of any personal, business, or financial relationships that the plan sponsor has if the relationship results in the service provider deriving any material benefit.

S. 2473 would require disclosure of any financial relationships that a service provider has with the plan sponsor and any third party providing services to the plan for which the service provider receives a payment.

H.R. 3765 would require a statement of (1) whether the service provider expects to remit any of the fees and expenses it receives under the contract to one or more third-party service providers or intermediaries, (2) the estimated amount to be remitted, and (3) the identity of each party. The bill would also require a statement of (1) whether the service provider expects to receive compensation from a source other than the plan or plan sponsor as a result of the contract, (2) the amount of such compensation, and (3) the identity of the source of the compensation. Amounts remitted to third parties and revenues received from sources other than the plan or plan sponsor would have to be disclosed only if they exceed \$5,000 during the year.

Disclosure of Impact Share Classes. Mutual funds may offer shares that offer differing services (with differing fees). For example, a mutual fund may have a share class that provides a low front-end load but may have a higher annual expense charge. Some mutual funds offer share classes that are available only to institutional investors; these share classes typically have lower fees and expenses compared to shares that are offered to retail investors. H.R. 3185 and S. 2473 would require disclosure of the existence of different share classes within the mutual fund investments offered. H.R. 3765 has no requirement to disclose differing share classes within mutual funds.

Frequency of Disclosure. H.R. 3185 and S. 2473 would require that a Service Disclosure Statement be provided to the plan sponsor either (1) after any material change to the terms of the service agreement or (2) at least annually. H.R. 3765 would require, within 90 days of the end of each plan year, the service provider to disclose to the plan sponsor the fees and expenses paid by the plan during the year, including an itemization of the fees paid for (1) investment management and (2) administration and record-keeping. The service provider would have to disclose amounts paid to third-parties and the identities of the third parties. It would also have to disclose the amount of compensation it received from parties other than the plan sponsor and the identity of each source of the compensation.

Disclosures from Plan Sponsors to Plan Participants. The following provisions in the bills would require plan sponsors to provide fee information to each plan participant, prior to any initial contribution or investment by the participant, in individual account plans where the participant exercises control over the assets in the account.

Disclosures Prior to Participants' Initial Contributions Required by H.R. 3185 and S. 2473. H.R. 3185 would require plan sponsors to provide an “Advance Notice of Available Investment Options” to all plan participants at least 10 business days prior to (1) a participant’s initial investment of any contribution to the plan on an annual basis and (2) the effective date of any material change in investment options in the plan. The notice would indicate which components of each investment option are payable directly by the participant and how such components are to be paid.

The following information would be required for each investment option: the name of the option, the investment objective, the risk level, whether the option by itself achieves long-term financial security, the historical return, the percentage fee, an explanation of any asset-based fees or annual fees, and a comparison to a nationally recognized index or benchmark. The notice would also include a statement that investment options should not be evaluated solely on the basis of charges but also on consideration of other factors such as risk and investment objectives.

S. 2473 would require plan sponsors to provide an “Advance Notice of Available Investment Options” to all plan participants 15 days prior to a participant’s initial investment of any contribution made to the plan. The following information would be required for each investment option: the name of the option, the investment objective, the risk level, whether the option by itself achieves long-term financial security, the historical return, the percentage fee, an explanation of any asset-based fees or annual fees, and a comparison to a nationally recognized index or benchmark.

The provisions in H.R. 3185 and S. 2473 requiring disclosure from service providers to participants would apply to individual account plans that permit participants to exercise control over the assets of their accounts.¹⁷

Plan and Investment Comparison Chart Required by H.R. 3185 and S. 2473. In addition to the “Advance Notice of Available Investment Options” mentioned above, H.R. 3185 would require a Plan Comparison Chart, and S. 2473 would require an Investment Comparison Chart that would detail the actual service and investment charges that will or could be assessed against the account in the plan year.

¹⁷ These are defined in 29 U.S.C. 1002(34): “a pension plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant’s account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant’s account.”

H.R. 3185 would require the Plan Comparison Chart to provide information in relation to the following three categories of fees: (1) charges that vary depending on the investment option selected (e.g., expense ratios or investment-specific asset-based charges), (2) charges that are assessed as a percentage of total assets in an account regardless of the investment option selected, (3) administration and transaction-based charges that are either automatically deducted each year (such as administration, compliance, or record keeping costs) or that are transaction-based (such as loan origination fees, possible redemption fees, or possible surrender charges), and (4) any other charges.

S. 2473 would require the Investment Comparison Chart to provide information in the following three categories of fees: (1) fees that vary depending on the investment option selected (e.g., expense ratios or asset-based fees), (2) fees that are assessed as a percentage of total assets in an account, and (3) administration fees that are either automatically deducted each year or that are transaction-based (such as loan origination fees). The investment comparison chart would have to describe the purpose of each fee and disclose the extent to which conflicts of interest may exist with respect to service providers or other parties receiving fees.

Disclosures Prior to Participants' Initial Contributions Required by H.R. 3765. H.R. 3765 would require plan sponsors to provide each participant, before any contributions are invested on his or her behalf, with a written explanation of the plan's fees and expenses. This enrollment notice would also include the following with regards to each investment alternative:

- the “key characteristics” of the plan’s investment alternatives and an explanation of the process of electing investment alternatives;
- a description of each investment alternative’s investment objectives, risk and return characteristics, historical rates of return, and the name of the fund manager;
- a statement of whether the investment alternative is actively or passively managed; and
- a statement of whether the investment 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.”

With respect to fees and expenses, the enrollment notice must disclose (1) annual asset-based fees for each investment alternative that reduce the investment’s rate of return and whether any of the fees or expenses applicable to a particular investment alternative are charged for services other than investment management, (2) fees and expenses that are charged for administration and record-keeping and an explanation of the way such fees are allocated to the participant’s account, (3) fees and expenses attributable to purchases or sales of interests in investment alternatives, (4) the “existence of” fees and expenses attributable to transactions or services initiated by the participant (other than for purchases and sales of investments) and the process by which participants can acquire additional information about these fees, (5) any other fees or expenses that may be charged to the participant, and (6) a statement explaining that fees are only one of the factors that a participant should consider when selecting an investment alternative.

The provisions in H.R. 3765 that require disclosure from service providers to participants would apply to DC plans that permit participants to exercise control over the assets in their accounts.¹⁸

Quarterly Benefits Statements Required by H.R. 3185 and S. 2473.

H.R. 3185 and S. 2473 would require plan sponsors to provide a quarterly statement of the fees and expenses that a participant has paid.

H.R. 3185 would require plan sponsors to provide information to each plan participant regarding the fees paid in their account. H.R. 3185 would require plan sponsors to provide each plan participant with a quarterly statement (plans that have fewer than 100 participants may provide an annual statement) that discloses the following information: the starting and ending balances of the participant's account; the employer and employee contributions made during the quarter; the investment earnings or losses on the account balance during the quarter; the actual or estimated charges that reduced the account during the quarter, expressed as dollars or as dollar charges as derived from an expense ratio; other charges in connection with the participant's account; and the process for obtaining the most recent Fee Comparison Chart.

Plan sponsors may provide reasonable and representative estimates of the charges, provided that the statement indicates the charge as being an estimate and provided the estimate is based on the previous year's experience.

S. 2473 would require plan sponsors to provide each participant in a DC plan in which the participant has the right to direct the investment of assets the following information in their quarterly benefits statements: the account's starting balance; the participant's vesting status; the employer and employee contributions made during the quarter; the interest earnings on the account balance during the quarter; the actual or estimated fees assessed during the quarter, expressed in dollars or as an expense ratio; the account's ending balance; the participant's asset allocation, categorized by investment option, including the current asset value and the change in the asset's value expressed as an amount and as a percentage; and the performance of the investment options selected by the participant during the quarter as compared to at least one nationally recognized market-based index. Plans that have fewer than 100 participants may provide the benefits statement on an annual basis.

S. 2473 would require a plan sponsor to provide, within 30 days of a participant's request, information on service fees charged against the participant's account for each investment option. The following information would be listed separately: fees that vary depending on the investment option selected, such as expense ratios, investment-specific asset based fees, or possible redemption fees or surrender charges; fees that are assessed as a percentage of total assets in the account, regardless of the investment option selected; administration and transaction-based fees; and any other fees that might be deducted from the participant's account.

¹⁸ These plans are described in 26 U.S.C. 402(c)(8)(B)(iii)-(vi): qualified trusts (such as 401(k) plans), 403(a) plans, 457 plans, and 403(b) plans.

Annual Statements Required by H.R. 3765. H.R. 3765 would require plan sponsors to provide each participant, within 90 days of the end of the plan year, with a written statement of the investment alternatives the participant had selected as of the end of the plan year and the key characteristics of each of these investment alternatives.

The statement must include the following information: a description of the percentage of the participant's assets invested in each asset class, the fees and expenses attributable to participant-initiated transactions (other than purchases and sales of assets) deducted from the participant's account, the fees and expenses for administration and record-keeping that were deducted from the participant's account, the annual asset-based fees for each investment alternative that reduced the investment alternative's rate of return, and the fees and expenses attributable to purchases or sales of each investment alternative that "have been or may be" deducted from the participant's account.

The annual notice also must include, with respect to each investment alternative, the percentage of the participant's assets invested in that alternative, a statement of whether the investment is actively or passively managed, a statement of the alternative's risk and return characteristics, and the investment's historical rates of return over the most recent one-, five-, and ten-year time period. It must also include a statement that explains that fees are only one of the factors that a participant should consider when selecting an investment alternative and that explain how the participant can access any information required to be disclosed in the enrollment notice that is not included in the annual notice.

Minimum Investment Option Requirement in H.R. 3185. ERISA § 404(c) protects plan sponsors from liability for investment losses in participant-directed DC plans. In order to continue to receive this protection, H.R. 3185 would require 401(k) plans to include at least one investment option that is a broad-based securities market based index fund or a combination of two or more such funds. The investment option should offer a combination of historical returns, risk, and charges that is likely to meet retirement income needs at adequate contribution levels. The bill specifies that the terms of the plan should indicate that the fund is offered without the endorsement of the government or plan sponsor. The bill does not specify particular funds, but examples might include life-cycle or index funds. Life-cycle funds alter their particular investment mix on the basis of the participant's investment time horizon. Index funds are mutual funds that replicate the movements of a group of investments. Index funds might track a large group of U.S. stocks (such as the Dow Jones Industrial Average or Standard & Poor's (S&P) 500 index), foreign stocks, or various kinds of bonds. Neither H.R. 3765 nor S. 2473 requires 401(k) plans to offer a particular investment option.

Assistance to Small Employers in H.R. 3185 and S. 2473. H.R. 3185 and S. 2473 would require the Secretary of Labor to provide educational and compliance materials to assist employers with fewer than 100 employees in selecting and monitoring service providers. The bills would also require the Secretary of Labor to provide services to assist employers with fewer than 100 employees in finding and understanding affordable investment options for the account plans. H.R. 3765 has no such provisions.

Enforcement and Review by the Department of Labor in H.R. 3185 and S. 2473. H.R. 3185 and S. 2473 would require the Secretary of Labor to widely disseminate the identity of service providers that engage in a pattern or practice of noncompliance with respect to the provisions relating to the Service Disclosure Statements and the Advance Notices of Available Investment Options. The bill would also require the Secretary of Labor to annually audit a representative sampling of individual account plans to determine their compliance with the requirements of the provisions relating to the Service Disclosure Statements and the Advance Notices of Available Investment Options and to report the results of the audit and any related recommendations to the House Committee on Education and Labor and the Senate Committee on Health, Education, Labor, and Pensions.

Imposition of Taxes in H.R. 3765. H.R. 3765 would impose a tax on service providers that failed to meet the requirements of the bill with respect to disclosure from service providers to plan sponsors. The amount of the tax would be \$100 per participant per day in the noncompliance period. H.R. 3765 would impose a tax on plan administrators that failed to meet the requirements of the bill with respect to disclosure from plan administrators to plan participants. The amount of the tax would be \$1,000 per participant for each day in the noncompliance period.