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COMMENTS ON HR 3185,
THE 401(k) FAIR DISCLOSURE FOR RETIREMENT SECURITY ACT OF 2007

UNDERSTANDING FEES IN ERISA-COVERED RETIREMENT PLANS

Employers who provide benefits to their employees under ERISA-covered retirement plans are required to operate such plans for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan. This requires plan sponsors to ensure that any fees paid with plan assets are reasonable. For the vast majority of plan participants this requirement and employers' commitment to providing valuable benefits has resulted in plan fees far below what an individual would pay in the retail market. For lower income workers with relatively small contributions, employer provided plans are the only viable option to save for retirement. Despite this success, PSCA members recognize the need for improvement in fee transparency to plan sponsors and participants.

PSCA has three broad principles for improved fee disclosure to participants:

> **Simplicity -** Employees face important decisions when contemplating their participation in a participant directed individual account plan. First, should I participate in this plan? Second, what plan investment alternatives should I select? These decisions should consider two types of plan fees – the fees for general plan costs and specific procedures that are incurred as the result of plan participation, and the specific fees associated with the investment allocation decision. Only fees paid by the participant are relevant. Precisely calculating plan fees paid by an employer may be impossible. There is no value in breaking the fees down into detailed components. Simplicity is critical to cost minimization for participants and employers.
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> **Sensitivity to costs -** Fee disclosure creates costs that will be borne by participants, either directly as an assessment against plan assets or indirectly as an element in employers' overall compensation structures. Obviously, the cost of disclosure varies proportionally with complexity. Fee disclosures should be based on "snap-shot" calculations and the use of estimates and examples. The ability to provide disclosure electronically is critical to minimizing costs.
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> **Flexibility –** How fees are disclosed to participants is critical to a successful and cost-effective disclosure program. Only employers, working with service providers, have the insight necessary to craft disclosure programs that will best serve their employees. Employers should be free to decide whether or not to combine fee disclosure with other communications, such as a benefit statement or annual report.

PSCA has been advocating improved fee disclosure to plan sponsors and participants for several years, including several appearances before the Department of Labor's Advisory Council on Employee Welfare and Pension Benefit Plans. The DOL currently has three distinct initiatives underway to improve fee transparency and disclosure. A final revised Form 5500, that lists expenses paid by a benefit plan, is expected at any moment. While filed by plan sponsors, it contains fee information provided by plan service providers. The revised form will significantly increase the fee information that is disclosed. A second initiative will result in a proposed rule in 2007 under ERISA section 408(b)(2) that will result in broad fee disclosure as a requirement to entering into a contract for plan services. The third DOL initiative involves enhanced fee disclosure to participants. The Department formally received recommendations in response to a request for information in July in preparation for a proposed rule in the near future. **PSCA supports the Department's initiatives. We believe that this is the best approach to enhance fee transparency in a measured and balanced manner and we urge Congress to delay consideration of any legislative action until the Department of Labor has completed its work**.

HR 3185 DISCUSSION

Unfortunately, the 401(k) Fair Disclosure for Retirement Security Act of 2007 fails to meet PSCA's criteria for simplicity, cost sensitivity, or flexibility. As noted above, we believe that Congress should wait to examine the DOL's final efforts before acting. In fact, Congressional action will likely result in delaying the regulatory reforms already underway at the DOL. While we are sure that Chairman Miller's intent is to improve 401(k) and similar plans, HR 3185 will likely result in new and unnecessarily complex disclosure requirements that will inhibit the growth of these plans, which growth is absolutely essential for the retirement security of American workers.

SECTION 1 – INTRODUCTORY MATERIAL

SECTION 2 - NEW ERISA SECTION 111 ENTITLED "SPECIAL REPORTING AND DISCLOSURE RULES FOR INDIVIDUAL ACCOUNT PLANS." The provision is limited to individual account plans subject to ERISA, with other specific limits for each subsection.

Subsection 111(a) establishes a "service disclosure statement" applicable to individual account plans with a qualified cash or deferred arrangement, or CODA (as defined in IRC 401(k)(2)). A plan administrator (usually the employer) or other official may not enter into a contract with a service provider without advance disclosure, in writing, from the service provider that 1), identifies who will perform plan services under the contract, including any affiliated or other third party; and 2), describes each service and expected total annual cost, itemized as to all relevant components, including <u>any amounts</u> to be paid to third parties or affiliates.

The itemization required in the disclosure statement must disclose at least the following:

- Sales commissions
- Start-up fees
- Investment management fees
- Investment advice fees
- Estimated trading expenses
- Administration and recordkeeping expenses
- Legal fees
- Trustee fees
- Any termination or surrender charges
- Total asset based fees
- Remuneration paid under SEC Rule 12b-1
- Commission paid under SEC section 28(e)
- Other costs as specified by the Secretary of Labor

Estimates. When actual amounts are not known, reasonable and representative estimates may be made by the plan administrator. Estimates must be identified as estimates. If later found to be materially incorrect, the plan administrator shall provide a corrected amount as soon as practicable. *Note – Committee staff has indicated that this provision is intended to apply to service providers that make the disclosure, not plan administrators.*

Financial relationships. The service disclosure statement must describe the nature of any conflicts of interest of each service provider due to a financial or personal relationship which the provider may have with the sponsor, plan, or other persons servicing the plan and for which the provider receives payments for services, including the extent to which the service provider uses its proprietary investments, any payments for including certain investment options as part of an investment menu, and other possible conflicts as may be specified by the Secretary of Labor.

Share class. The impact of share class must be disclosed if classes other than "retail shares" are included in the plan.

Revenue Sharing. If any service is provided to the plan, or plan sponsor in connection with the plan, by any service provider "without charge or for fees set at a discounted rate or subject to rebate," the disclosure statement shall describe the extent and amount by which consideration is otherwise obtained by the service provider, the plan, or the plan sponsor for such services, directly or indirectly, by means of any charges against the participants' or beneficiaries' accounts.

Service disclosure statements must be updated annually and within 30 days of any material changes for the term of the contract.

Exclusion. Services less then $1,000 are excluded from these requirements.

***Comments** – The DOL's pending proposed regulatory changes under section 408(b)(2) will result in similar disclosures, provided at the same general point in time, as this new provision. The provision in HR 3185 is in addition to, and duplicative with, the existing fiduciary requirement to ensure that plan fees paid with plan assets are reasonable. Under the DOL's approach, the disclosures will be incorporated into the fiduciary requirements regarding plan fees by making noncompliance a prohibited transaction.*

The provision requires the "unbundling" of a bundled provider that incorporates all services under a single price or broad category of prices. PSCA is a strong advocate of increased transparency and the need to reconcile asset-based fees that grow as assets increase with relatively fixed costs for plan administration and per-participant recordkeeping. Provided that the plan administrator is completely aware of all the services included in a bundled arrangement and the actual total costs for those service (in dollars), what is the purpose of this provision? Again, Congress should wait for the Department of Labor to act on this complicated issue.

The requirement to disclose "conflicts of interest" is puzzling. "Conflict of interest" is not defined, but it could mean arrangements that constitute a prohibited transaction prohibited under current law. To the degree it is a subjective decision, a service provider could decide to not make a disclosure. In any event, failure to disclose a conflict would not likely excuse a named fiduciary's requirement to ensure that the plan is operated for the exclusive benefit of the plan participants and beneficiaries. This requirement appears to be redundant with the general fee disclosure requirements.

The purpose of the share class disclosure requirement is not clear. While 401(k) plan participants generally pay "retail" prices and frequently pay far less; there are myriad costs associated with administering a 401(k) plan that do not apply to individual ownership of a mutual fund. This could result in additional costs for participants in some plans, particularly new small business plans. A comparison with a "retail share" in this situation could result in an incorrect conclusion that the plan was paying unreasonable expenses. This type of analysis might also ignore the effect on participants' overall costs of the preferential tax treatment for qualified plans and the benefits of an employer contribution.

Availability to participants. A plan sponsor or plan administrator must provide a copy of the service disclosure statement within 30 days of receipt of a request by a participant or beneficiary and post such statements on any Intranet website maintained by the plan sponsor or plan administrator on behalf of the sponsor.

***Comments** – This provision will likely result in making proprietary information publicly available. Whether or not this will result in lower plan fees is questionable. Additionally, it is not clear how this information will assist plan participants in understanding the impact of fees on their investment decisions. Presumably, the information will include fees paid for with corporate, not plan, assets. Fees paid in this manner have no impact on participants. Plans are currently required to provide a summary plan description, a statement of material modification, and an annual report. Additionally, the Form 5500 is available to plan participants and beneficiaries. The revised Form 5500 will provide extensive information about plan expenses and should remove the need for this new requirement.*

Subsection 111(b) mandates the provision of an advance notice of investment election information to participants and beneficiaries in participant directed individual account plans. The information must be provided 15 days prior to the beginning of the plan year and any effective date of any material change in investment options; or, if later, the date a participant commences participation. The notice must include the following information for each investment option:

- Name of the option
- Investment objectives
- Risk level
- Whether option is a "comprehensive investment designed to achieve long-term retirement security or should be combined with other options in order to achieve such security"
- Historical return and percentage fee assessment
- Explanation of differences between asset-based and other annual fees
- Benchmarking against a nationally recognized market-based index or other benchmark retirement plan investment
- Where and how additional plan-specific and generally available investment information regarding the option can be obtained

The notice must include any form necessary for making elections and a statement explaining that investment selection should not be based solely on fees but on other factors such as risk and historical returns.

***Comments** – We agree that fee information should not be provided in a vacuum. However some of these attestations, such as risk level, an opinion whether or not an investment is designed to achieve retirement security, and the benchmarking requirement are problematic. For example, a "benchmark retirement plan investment" does not currently exist. The provision is especially problematic for investments that are not mutual funds or based on mutual funds, such as separately managed accounts, because some of the required data may not be available. The reference to historical returns is interesting given that historical returns are not a reliable indicator of future performance.*

Fee menu. The notice must include a fee menu of the potential service fees that could be assessed against the account in the plan year. The menu must be easily understandable and include such information as the Secretary of Labor determines necessary to permit participants to assess the potential services that could be provided in connection with the investment options and potential fees that could be assessed against an account for such services.

Fees must be categorized as, 1), varying by investment option (including expense ratios, investment fees, redemption fees, surrender charges); 2), asset-based fees assessed regardless of investment option selected; and 3), administration and transaction fees, including plan loan fees, that are either automatically deducted each year or result from certain transactions.

The fee menu shall include a general description of the purpose of each fee, i.e., investment management, commissions, administration, recordkeeping. The menu will also include disclosure of potential conflicts of interest that may exist with service providers or parties in interest, as directed by the Secretary. The Secretary will prescribe a model notice and fee menu. Plan administrators may use reasonable estimates when actual amounts are unknown.

***Comments** – We support the concept of a fee menu, but not the detail required in this provision. Flexibility should be provided to ensure that the plan administrator can tailor the disclosure to meet the needs of plan participants. The requirement to disclose a "potential conflict of interest" is discussed previously. This particular disclosure (conflicts) will likely result in a lengthy legal-like document that confuses most participants, provides no information that will assist in the investment decision, and adds considerably to the fee menu, increasing the likelihood that the entire document will be ignored.*

Section 111(c) provides for annual participant benefit statements for participant directed individual account plans. The statement must be provided not later then 90 days after the end of the plan year and include the following:

- Starting balance
- Vesting status
- Contributions by employer and employee during the plan year
- Earnings during the plan year
- Fees assessed in the plan year
- Ending balance
- Asset allocation by investment option, including current balance, annual change, net return as an amount and a percentage
- Service fees charged in the year for each investment, including, separately, investment fees (expense ratios and trading costs), load fees, total asset based fees (including variable annuity charges), mortality and expense charges, GIC fees, employer stock fees, directed brokerage charges, administrative fees, participant transaction fees, total fees, and total fees as a percent of current assets
- The annual performance of the investment options selected by the participant as compared to a nationally recognized market based index
- The plan administrator may include historical return and risk data and the "amount that the participant needs to save each month to retire at age 65"

Estimates may be used as necessary when actual information is unknown. The Secretary of Labor shall prescribe a **model annual benefit statement**.

***Comments** – Recordkeeping systems are not currently able to meet all the requirements of this provision. Additional costs to participants will result from the system changes needed to comply. Estimates should be permitted whenever the plan administrator determines that a cost-benefit analysis favors the use of estimates over actual calculations. Much of the required data is already required to be disclosed in the new benefit statement requirements included in the Pension Protection Act, yet there is no coordination of the two requirements. The provision to calculate earnings and fees assessed during the year will be* *particularly difficult in situations in which an investment change occurred during the year or for partial-year participation. Fees for investments made through a brokerage window may be impossible for a recordkeeper to track. The performance benchmarking requirement will create significant compliance issues, especially for non-mutual fund based investments.*

Subsection 111(d) provides that nothing in section 111 shall be construed to limit, or serve as the basis of any interference regarding, the fiduciary duties under section 404(a)(1)(A)(ii), regarding defraying reasonable expenses of administering the plan.

***Comments** – This provision confirms fears that the bill creates new reporting requirements that do not provide any assurance that meeting the requirements satisfies any of the fiduciary requirements related to plan fees. The DOL approach is to integrate the new disclosure requirements into the existing fiduciary rules.*

Subsection 111(e) directs the Secretary of Labor to make available to small employers educational and compliance materials to assist them in selecting and monitoring service providers, selecting investment options, and understanding fees.

Subsection 111(f) mandates the Secretary of Labor to provide assistance to plan sponsors, participants, and beneficiaries with any questions regarding compliance with this section.

ENFORCEMENT – ERISA section 502(c)(7), that permits assessment of a civil penalty of $100 per day per participant against the plan administrator, is amended to apply to violations of section 111.

***Comments** – Plan administrators may be held liable for failures by service providers to provide accurate or timely data.*

Section 111 is effective for plan years beginning after the date of enactment.

***Comments –** The transition period for such an undertaking is woefully inadequate. Some plans could face an effective date within days of enactment; others could have almost a full year. Even the latter period is inadequate.*

SECTION 3 - MINIMUM INVESTMENT OPTION REQUIREMENT

ERISA section 402 is amended to provide that all participant directed individual account plans shall include at least one investment option which is a nationally recognized market-based index fund that, as determined by the DOL, offers a combination of historical returns, risks, and fees that is likely to meet retirement income needs at adequate levels of contribution. Effective for plan years beginning after enactment.

***Comments –**The proposed provision usurps a plan sponsor decision maker's determination of what types of investments, taken together, enable participants to invest adequately for their retirement by reaching a values conclusion that this is an appropriate option for all plans. Further, if this provision is enacted, future policymakers will be tempted to impose their values conclusions as well. In the past, Congress has considered whether it should mandate or prohibit economically targeted investments or investments that take into account social concerns. Congress wisely chose to leave the final decision to plan fiduciaries.*

In addition, this proposal would direct the government to determine the "combination of historical returns, risks, and fees likely to meet retirement income needs at adequate levels of contribution." There is no such standard, nor should there be. Retirement income needs are dependent upon each person's situation. Factors like marital status, health, spending patterns and non-plan savings all contribute to an individual's definition of need. Further, such an approach would be rigid and inflexible. Delegating this determination to a regulatory agency at a time when the lengthening life span and investment innovation demand the greatest flexibility possible is a cause for concern.

SECTION 4 - ADVISORY COUNCIL ON IMPROVING EMPLOYER-EMPLOYEE RETIREMENT PRACTICES

ERISA section 519 is amended to create a new council within the DOL composed of twelve members; six selected by the President; three by the Chairman of the House Committee on Education and Labor; and three by the Chairman of the Senate Committee on Health, Education, Labor, and Pensions. Six members will represent participants and six members will represent employers. The Council's duties are to solicit information on issues affecting plans and to consider such submissions; hold hearings as appropriate; issue advisories on best practices; present research; issue benchmarking information; establish a website; issue annual reports, and make recommendations. The Council will also issue an annual report of retirement trends and issues to Congress and the public.

***Comments** – The Department of Labor has an Advisory Council on Employee Welfare and Pension Benefit Plans that was created in ERISA. The Council is comprised of representatives of employees, employers, and service providers. As noted, it played a critical role in the DOL's current initiatives involving fee disclosures. Is this new Council expected to replace the current Council?*

SECTION 5 - ENFORCEMENT COORDINATION AND REVIEW BY DOL

ERISA section 502 is amended to require the Secretary of Labor to notify the applicable regulatory authority in any case where the Secretary determines that a service provider is engaged in practices that preclude compliance with section 111 by plan administrators. The Secretary will widely disseminate the identity of any service providers engaged in such practices. The DOL shall conduct audits of compliance with section 111 and annually report on such audits to Congress. The Secretary will make recommendations within eighteen months of enactment regarding measures to simplify reporting for employee pension benefit plans.

***Comment –** Congress should wait to see how the DOL intends to enforce violations of its new disclosure initiatives before embarking on a new enforcement scheme. For example, the DOL intends to use the current prohibited transaction enforcement scheme in its new rules on fee disclosure to plan administrators. This approach gives the Department direct control of service providers who violate the disclosure rules. Congress should determine if the DOL already shares information with other agencies regarding service provider misconduct before enacting a new requirement. This provision does not appear to provide any direct sanctions against service providers other than the dissemination of the identity of any service provider "found to be engaged" in a noncompliant pattern or practice. The new law does not provide for a notice, hearing, or appeal procedure prior to the dissemination of the finding.*