Congressional Research Service

Fee Disclosure in Defined Contribution Retirement Plans: Background and Legislation

John J. Topoleski
Analyst in Income Security

January 7, 2011

Congressional Research Service
7-5700
www.crs.gov
RL34678

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 bills introduced in the 111th and 112th Congresses that address fee disclosure in retirement plans. In the 111th Congress, these bills are H.R. 2779, the Defined Contribution Plan Fee Transparency Act of 2009, introduced by Representative Neal on June 9, 2009; H.R. 2989, the 401(k) Fair Disclosure and Pension Security Act of 2009, introduced by Representative Miller on June 23, 2009; S. 401, the Defined Contribution Fee Disclosure Act of 2009, introduced by Senator Harkin on February 10, 2009; and H.R. 4146, the Sensible Transparency for Retirement Plans Act of 2009, introduced by Representative Kline on November 19, 2009. H.R. 2989 was reported out of committee on June 24, 2009.

This report will be updated as legislative action warrants.

Contents

Figures

Tables

Contacts

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 or employers, or both, 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.

Some have raised concerns about the fees that participants in 401(k) plans are charged. Small differences in fees can yield large differences in account balances 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.

[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).

[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.

Table 1. Effect of Annual Fees on a $20,000 Balance (Assuming 7.0% Annual Real Rate of Return)

(amount in $)

	Annual Fee			
Account Balance	**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]

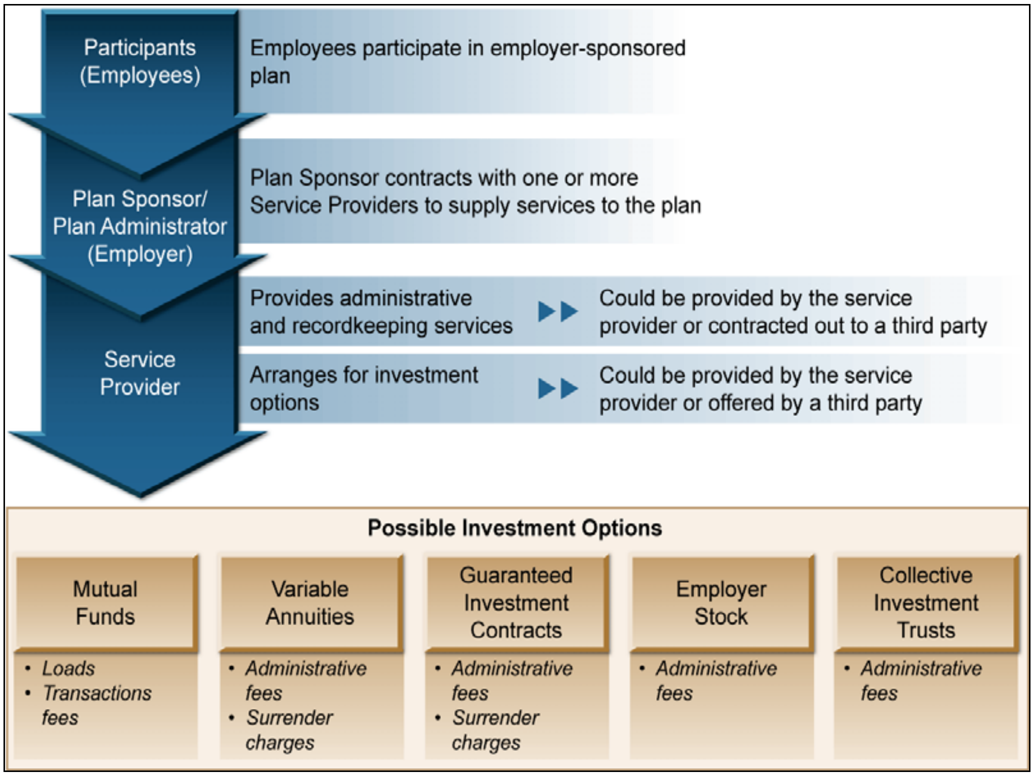
Structure of 401(k) Plans

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. 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.

[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).

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]

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.

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

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. One of the proposals in Congress (S. 401) 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.

Table 2. Number of Defined Contribution Plans and Participants, by Size of Plan and Extent of Participant Direction of Investments, 2006

		All Plans	Plans With 2 - 99 Participants	Plans with 100 or More Participants
All Plans	Number of Plans	451,993	389,793	62,200
	Number of Participants (in thousands)	58,352	7,955	50,397
Participant Directs All Investments	Number of Plans	383,442	325,980	57,462
	Number of Participants (in thousands)	46,674	6,999	39,675
Participant Directs Portion of Assets	Number of Plans	19,672	17,114	2,558
	Number of Participants (in thousands)	8,693	325	8,368
Participant Does Not Direct Any Investments	Number of Plans	48,882	46,700	2,182
	Number of Participants (in thousands)	2,984	631	2,353

Source: U.S. Department of Labor, Table D-6 of Private Pension Plan Bulletin, Abstract of 2006 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.

Types of 401(k) Fees

The Employee Benefits Security Administration (EBSA) is an agency within 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.

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

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.

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.

---

[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.

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 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

---

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

[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.

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

Four bills introduced in the 111th Congress address the expenses and fees charged in 401(k) and other DC plans. H.R. 2779, H.R. 2989, H.R. 4146, and S. 401 would have required service providers to disclose to plan sponsors the services to be provided to the plan and the expected fees and expenses. The disclosures would have had to 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 have required plan sponsors to disclose to a participant the expected fees and expenses associated with the plan and the plan's investment options. This disclosure would have had to be made prior to any initial contribution by a participant. Plan sponsors would also have had 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. 2989 and S. 401

Representative George Miller introduced H.R. 2989, the 401(k) Fair Disclosure and Pension Security Act of 2009, on April 21, 2009.[14] H.R. 2989 would have (1) required greater disclosure of fees paid in 401(k) plans, (2) provided for independent investment advice for participants in DC plans, and (3) provided temporary funding relief to defined benefit plans. This bill was reported out of the House Education and Labor Committee on June 24, 2009, by a vote of 29 - 17. Senator Tom Harkin introduced S. 401, the Defined Contribution Fee Disclosure Act of 2009, on February 9, 2009. In many respects, S. 401 and the fee disclosure provisions of H.R. 2989 are similar.[15]

The provisions in H.R. 2989 that would have required greater disclosure of 401(k) fees and S. 401 would have amended ERISA and would have required

[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.

[14] Representative Miller introduced H.R. 1984, the 401(k) Fair Disclosure for Retirement Security Act of 2009, on April 21, 2009. H.R. 1984 was passed by the subcommittee on Health, Employment, Labor and Pensions of the House Education and Labor Committee on June 17, 2009, by a vote of 13 – 8. The provisions of this bill were included in H.R. 2989.

[15] In the 110th Congress Representative Miller introduced H.R. 3185, the 401(k) Fair Disclosure for Retirement Security Act of 2007, on July 26, 2007. H.R. 3185 was approved by the House Education and Labor Committee on April 16, 2007, and was similar to H.R. 1984. Senator Harkin introduced S. 2473, the Defined Contribution Fee Disclosure Act of 2007, on December 13, 2007. S. 2473 was nearly identical to S. 401. Representative Neal introduced H.R. 3765, the Defined Contribution Plan Fee Transparency Act of 2007, on October 4, 2007.

- 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.[16]

Minimum Investment Option Requirement in H.R. 2989

H.R. 2989 had an additional requirement not found in S. 401 or H.R. 2779. H.R. 2989 would have required each 401(k) plan to include at least one investment option that is a broad-based market index fund that would likely meet retirement income needs at adequate levels of contributions. 401(k) plans that did not include such an option would lose their protection against liability from participants' investment losses under ERISA § 404(c).

H.R. 2779

Representative Richard Neal introduced H.R. 2779, the Defined Contribution Plan Fee Transparency Act of 2009, on June 9, 2009. This bill would have imposed taxes on service providers and plan sponsors that failed to meet the requirements of the bill. The bill would have amended the Internal Revenue Code and would have required

- plan sponsors to provide participants with disclosures of fees and expenses prior to prior to making investments in the plan;
- plan sponsors to provide each participant in the plan a quarterly 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.

H.R. 4146

Representative Kline introduced H.R. 4146, the Sensible Transparency for Retirement Plans Act of 2009, on November 19, 2009. The bill would have amended ERISA and would have required

[16] 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.

- Service providers to disclose to disclose to plan administrators the services to be provided and the total compensation to be received under an arrangement to provide services to the plan;
- Plan sponsors to provide to participants a description of the direct fees and expenses that may be charged against the account and a description of the investment options available under the plan;
- Plan sponsors to provide participants with a quarterly benefit statement that details the amount of a participant's balance in each of the plan's investment options.

Details of 401(k) Fee Legislation

Disclosure from Service Providers to Plan Sponsors

H.R. 2779, H.R. 2989, and S. 401, and H.R. 4146 would have required 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. 2989 would have required 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 have been adjusted for inflation beginning in 2011.

S. 401 would have required 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 have applied 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. 2779 would have required service providers to provide an "initial disclosure" statement prior to entering into or materially modifying a contract for the provision of plan services.

H.R. 4146 would have required service providers to provide the disclosure prior to or at the time the arrangement is entered into.

Kinds of Pension Plans

The provisions in H.R. 2989 and S. 401 requiring disclosure from service providers to plan sponsors would have applied to "individual account plans."[17] The provisions in H.R. 2779 would have applied to "applicable defined contribution plans" for which the total fees that the service

[17] 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."

provider, its affiliates, and any subcontractor receive exceeds $5,000. Both definitions include 401(k) plans, 403(a) plans, and 457(b) plans.[18]

Bundled Service Charges

H.R. 2779, H.R. 2989, and S. 401 would have required service providers to report the fees and expenses within several categories.

H.R. 2989 would have required 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. 401 would have required 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. 2779 would have required 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. The bill would also have required (1) a detailed and itemized list of services to be provided by the service providers, its affiliates, or subcontractors and (2) a schedule of fees and expenses associated with participant-initiated transactions or services.

H.R. 4146 would have required service providers to disclose the services to be provided to the plan and the amount of total compensation that the service provider would receive under the arrangement. The service provider would have been required to disclose the amount of direct compensation received from the plan and the amount of indirect compensation received by persons who are not an affiliate of the plan.

Form of Charges and Permission of Estimates

H.R. 2779, H.R. 2989, and S. 401 would 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. 2989, plan administration and record keeping and investment management charges would have been presented as aggregate dollar amounts. Transaction-based charges may be presented as percentages of applicable base amounts. Reasonable and representative estimates of the charges would be permitted, provided the statement indicates the charge as being an estimate and provided the estimate is based on the previous year’s experience.

S. 401 would have allowed each charge to be expressed as either a dollar amount or as percentage of assets. The form of such charges would have had to be consistent throughout the statement. In cases where services are bundled or the costs are unknown, S. 401 would have required service providers to provide reasonable and representative estimates of charges.

[18] Specifically, H.R. 3765 would have applied 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. 2779 would have allowed the fees and expenses to be expressed as either a dollar amount or as a percentage of assets (or a combination thereof). H.R. 2779 would have allowed 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.

H.R. 4146 would not have required that fees be disclosed in a particular form, either as dollar amounts or as percentages of dollar amounts.

Third Party Payments

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

H.R. 2989 would have required disclosure of any payments that the service provider receives from any person providing services to the plan. It would also have required 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. 401 would have required 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. 2779 would have required a statement of (1) whether the service provider expects to remit any of the fees and expenses it receives under the contract (including commissions, finders fees, and sales loads) 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 have required 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. In addition, the service provider would have to disclose whether they would benefit from offering proprietary investment options.

H.R. 4146 would not have required the disclose of third party payments.

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. 2989 would have required disclosure of the existence of different share classes within the mutual fund investments offered. S. 401 would have required such disclosure as well. H.R. 2779 would have required that service providers supply a statement that indicates that investment options available to the plan may be offered at different prices outside of the plan. H.R. 4146 would not have required the disclose of impact share classes.

Frequency of Disclosure

H.R. 2989 and S. 401 would have required 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. 2779 would have required, by the due date for filing annual form 5500, 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 had to disclose amounts paid to third-parties and the identities of the third parties. The service provider would also have had to disclose the amount of compensation it received from parties other than the plan sponsor and the identity of each source of the compensation. H.R. 4146 would have required the disclosure to plan administrators regarding compensation to occur every year within 60 days of the plan year.

Disclosures from Plan Sponsors to Plan Participants

The following provisions in the bills would have required 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. 2989 and S. 401

H.R. 2989 would have required 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 have indicated which components of each investment option are payable directly by the participant and how such components are to be paid.

The following information would have been 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 have included 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. 401 would have required 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 have been 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. 2989 and S. 401 requiring disclosure from service providers to participants would have applied to individual account plans that permit participants to exercise control over the assets of their accounts.[19]

Plan and Investment Comparison Chart Required by H.R. 2989 and S. 401

In addition to the "Advance Notice of Available Investment Options" mentioned above, H.R. 2989 would have required a Plan Comparison Chart, and S. 401 would have required an Investment Comparison Chart that would have detailed the actual service and investment charges that would or could be assessed against the account in the plan year.

H.R. 2989 would have required 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. 401 would have required 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 had 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. 2779

H.R. 2779 would have required plan sponsors to provide each participant, a reasonable time before any contributions are invested on his or her behalf, with an explanation of the plan's fees and expenses. This enrollment notice would also have included the following with regards to each designated 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;
- an explanation on restrictions on transfers to and from the investment alternative;

[19] 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."

- a statement of whether the investment alternative is actively or passively managed;
- 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";
- the rates of return for the investment and an appropriate market index over the preceding one-, five-, and ten-year period; and
- the fees and expenses in connection with sales and purchases of the investment alternative, such as sales loads or surrender values.

With respect to fees and expenses, the enrollment notice would have had to disclose (1) the total operating expenses for each investment alternative and the 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) 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, (4) any other fees or expenses that may be charged to the participant, (5) a statement of where additional information on particular investment alternatives is available, 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. 2779 that would have required disclosure from service providers to participants would have applied to DC plans that permit participants to exercise control over the assets in their accounts.[20]

Disclosures Prior to Participants' Initial Contributions Required by H.R. 4146

H.R. 4146 would have required plan administrators to provide to plan participants a notice that provides a description of the direct fees and expenses that may be charged against the account and a description of the investment options available under the plan. The notice would have included an explanation for administrative fees to be paid and an explanation of fees for any services to be provided on an individual basis to participants, such as plan features or services. The notice would also have had a description of investment options available under the plan. For each investment option, the notice would have described (1) the name of the investment option; (2) the investment objective; (3) the principle risks; (4) the fees associated with the investment option; (5) the historical return for the previous one, five, and ten years; (6) whether the investment option was diversified to minimize the risk of large losses; (7) whether the investment option was actively or passively managed; and (8) how the participant may receive additional information on the investment option. The notice would have been required to include a statement that investment options should not be evaluated based solely on the fees charged. The statement

[20] 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.

would also have had to be presented in a manner which would be understood by the typical participant.

The provisions in H.R. 2779 that would have required disclosure from service providers to participants would apply to DC plans that permit participants to exercise control over the assets in their accounts.

Quarterly Benefits Statements Required by H.R. 2989 and S. 401

H.R. 2989 and S. 401 would have required plan sponsors to provide a quarterly statement of the fees and expenses that a participant has paid.

H.R. 2989 would have required plan sponsors to provide information to each plan participant regarding the fees paid in their account. H.R. 2989 would have required plan sponsors to provide each plan participant with a quarterly statement (plans that have 100 or fewer participants could provide an annual statement) that disclosed 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 loses 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 could have provided reasonable and representative estimates of the charges, provided that the statement indicated the charge as being an estimate and provided the estimate is based on the previous year's experience.

S. 401 would have required 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 had fewer than 100 participants could have provided the benefits statement on an annual basis.

S. 401 would have required 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 have been 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.

Quarterly Statements Required by H.R. 2779

H.R. 2779 would have required plan sponsors to provide each participant, at least once each calendar quarter, with an explanation of the investment alternatives the participant had selected as of the last day of the plan quarter and the key characteristics of each of these investment alternatives.

The statement would have had to include the following information: a description of the percentage of the participant's assets invested in each asset class, the total administrative and record-keeping fees and expenses that were deducted from the participant's account, the total 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, record-keeping, and purchases and that were deducted from the participant's account, and the fees and expenses attributable to purchases or sales of each investment alternative that have been deducted from the participant's account.

The quarterly notice also would have had to 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 also would have to include a statement that explains that fees are only one of the factors that a participant should consider when selecting an investment.

Quarterly Benefits Statements Required by H.R. 4146

H.R. 4146 would have required plan administrators to provide to participants a quarterly statement that would contain the following information: (1) the starting balance on the account; (2) the contributions made to the account; (3) the investment earnings or losses; (4) any direct charges to the account; (5) the ending account balance; (6) the participant's asset allocation to each investment option; and (7) the historical return and fees (including an example) associated with each investment option. The fees could have been provided as reasonable and representatives estimates but would have to be disclosed as estimates. Plans with under 100 participants could provide the statement annually.

Minimum Investment Option Requirement in H.R. 2989

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. 2989 would have required 401(k) plans to include at least one investment option that is an index fund designed to substantially match the performance of the U.S. equity market, the U.S. bond market, or a combination of the U.S. equity and bond markets The investment option should have offered a combination of historical returns, risk, and charges that is likely to meet retirement income needs at adequate contribution levels. The bill specified that the terms of the plan should indicate that the fund is offered without the endorsement of the government or plan sponsor. The bill did not specify particular funds, but examples might have included 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. H.R. 2779 and S. 401 did not require 401(k) plans to offer a particular investment option.

Assistance to Small Employers in H.R. 2989 and S. 401

H.R. 2989 and S. 401 would have required the Secretary of Labor to (1) provide educational and compliance materials to assist employers with fewer than 100 employees in selecting and monitoring service providers and (2) provide services to assist employers with fewer than 100 employees in finding and understanding affordable investment options for the account plans. H.R. 2779 had no such provisions.

Enforcement and Review by the Department of Labor in H.R. 2989 and S. 401

H.R. 2989 and S. 401 would have required the Secretary of Labor to widely disseminate the identity of service providers that engaged 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. H.R. 2989 and S. 401 would have required 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. 2779

H.R. 2779 would have imposed 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 have been $1,000 per day in the noncompliance period. H.R. 2779 would have imposed 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 have been $100 per participant for each day in the noncompliance period, with a maximum penalty of the maximum of the lesser of 10% of plan assets or $500,000.

Author Contact Information

John J. Topoleski
Analyst in Income Security
jtopoleski@crs.loc.gov, 7-2290