

## Preparing to Disclose Fees to Defined Contribution Plan Participants who Self-Direct Investments in their Accounts

Sponsors of private sector defined contribution (DC) plans that offer participant-directed investments, including Sections 401(k) and 403(b) plans, should begin to prepare for the additional transparency that will be required when the proposed regulation on participant fee disclosures that the Department of Labor (DOL) issued this past summer is made final. In addition, the DOL has issued a proposed regulation on disclosure of information to plan sponsors. (The [text box at the bottom of the last page](#) summarizes what the proposed regulations would require.) It is still unclear when the final versions of these proposed regulations, which are proposed to take effect for plan years beginning on or after January 1, 2009 and 90 days after publication in the *Federal Register*, respectively, will be issued.\*

It is, however, very clear that plan sponsors are being held to a higher standard of due diligence in ongoing operations of DC plans and are well advised to secure and analyze critical information now in fulfillment of this obligation. In fact, the proposed DOL regulations should be taken seriously as a *minimum* indicator because the proposals (especially the provider fee disclosure proposals) have been criticized by participant groups and other commentators, including influential Congressional Democrats, for not disclosing enough.\*\* This *Spotlight* presents an overview of the implications and notes steps that plan sponsors may want to take now in order to ensure they are prepared to comply with the final regulations when they are issued.

### WHAT ARE THE IMPLICATIONS?

The important legal innovation in the proposed participant-disclosure regulation was the DOL view that making detailed fee disclosure requirements is a basic fiduciary requirement in the case of a participant-directed plan, not just a requirement for plans to fit within the fiduciary shelter of ERISA's §404(c). Independent of the regulations, that position will be a powerful spur to more disclosure. The new disclosure requirements are likely to affect plan sponsors in the following ways:

- **Collection and Review of Information from Service Providers** Plan sponsors would be required to secure full and complete information concerning all of the administrative and investment-related fees charged to their plan. As part of their fiduciary duties under ERISA, the responsible plan fiduciaries would be required to conduct an objective review of this information to, among other things, analyze each vendor's aggregate compensation and fees from the plan for reasonableness and potential conflicts of interest, in addition to assessing the qualifications of the service provider and the nature and quality of the services that will be provided in light of what the plan is paying for them.
- **Revised Service Contracts** Service contracts would need to be revised to require the service provider to provide the information that the sponsor must disclose, and to update it with any material changes to the required information. This would include the obligation

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\* In their September comments to the DOL, a number of commentators requested a one-year delay in the effective date because they noted the January 1, 2009 date would not be practical. As the final regulation is not yet out, that concern has become more acute.

\*\* Representative George Miller (D-CA), chair of the House Committee on Education and Labor, proposed legislation last year (H.R. 3185) that would set additional and stricter ground rules, going beyond the requirements of the proposed regulations. President-elect Obama's campaign agenda included increasing disclosure on plan fees and investments.

to provide information necessary for completion of Form 5500 and information necessary for the plan sponsor to comply with disclosure obligations to plan participants and beneficiaries.

- **Disclosure to Plan Participants** Plan sponsors would be required to provide general plan and administrative expense information and individual expense information, in an easy-to-read comparative format, on or before the date of eligibility and at least annually thereafter. In addition, the actual dollar amounts charged to each account would have to be disclosed at least quarterly, with the individual benefit statement.
- **Plan Oversight** Receipt and distribution of the additional information would not relieve plan fiduciaries of the requirement to monitor services arrangements and the performance of service providers. All of the proposed guidance emphasizes the basic proposition that participant disclosure does not relieve a fiduciary from the responsibility to prudently select and monitor investment managers and investment alternatives offered.

### WHAT CAN PLAN SPONSORS DO NOW TO GET READY?

Plan sponsors may want to prepare to comply by doing some or all of the following:

- **Review current service contracts to evaluate current service offerings, performance guarantees and expense.** This review should be conducted in the context of service objectives and the demographic factors influencing market-related benchmarks.
- **Review current investment options and their fee structures, risk profiles and benchmark their performance.** A market-based analysis of all investment related fees should be conducted to assure that the plan has access to each fund at the lowest cost available, recognizing plan size and demographics.
- **Consider broadening/updating investment/distribution options.** Given the increasing importance of DC plans as a primary retirement vehicle, plan sponsors should reexamine the array of investment and distribution alternatives being offered. New options might be added and/or redundant ones eliminated with the goal of making it easier for participants to choose. In addition, a growing number of investment and distribution alternatives have been introduced to the market over the last several years (*i.e.*, managed accounts, brokerage accounts, annuity type accumulation and distribution vehicles), a trend that is expected to continue. It is prudent for plan sponsors to consider these alternatives, however, appropriate due diligence must be conducted to assure that maximum value is provided for plan participants.
- **Consider consolidating offerings, in the case of §403(b) plans.** Sponsors of §403(b) plans in particular, many of which have multiple service providers and numerous investment options, may want to consider a consolidation of service providers and a reduction in the number of offerings so the choice based on comparative information is less daunting for participants. This will also be critical in meeting the requirement of the final IRS §403(b) regulations, effective January 1, 2009. In meeting this objective, plan sponsors should consider adopting an investment policy statement to form the basis for selection of an appropriate array of best-in-class offerings. In addition, issues associated with existing back-end loads and migration of assets must be evaluated.
- **Install procedures to assure adequate oversight of investment managers.** In addition to the increased focus on DC plans as primary retirement income vehicles, the legislative focus on participant fee disclosure, the proposed DOL regulations, Securities and Exchange Commission investigations associated with investment fund operations, and a growing number of class action lawsuits focused on administrative and investment-related fees have placed greater focus on the role of the plan fiduciaries in overseeing the ongoing

operations of DC plans. Most professionals advise that due diligence include the formation of an administrative committee, an investment committee or subcommittee, with support from an expert, independent third party, to focus on this.

- **Develop a communications strategy.** The required disclosures may be difficult for participants to understand despite the goal of simplicity and clarity. Plan sponsors should treat the need to provide enhanced participant disclosure as an opportunity to communicate the organizations' retirement plan philosophy and the importance of participation at increased levels of deferral to meet retirement objectives. Focused communications at appropriately timed intervals in combination with enhanced tools and resources for retirement planning will enhance the value of the plan for participants, as well as demonstrating plan sponsor due diligence.



*As with all issues involving the interpretation or application of laws and regulations, plan sponsors should rely on their attorneys for authoritative advice on their fiduciary responsibilities. To discuss reviewing DC plan investment options and the steps described above, contact your Segal Advisors consultant or the nearest Segal Advisors office.*

## THE PROPOSED REGULATIONS IN BRIEF

The DOL is proposing fee-disclosure criteria that would have to be met in order for a service-provider contract to qualify as a reasonable contract or arrangement under §408(b)(2) of the Employee Retirement Income Security Act (ERISA), which is necessary to avoid a prohibited transaction. Specifically the contract or arrangement must be in writing and require the service provider to disclose required information on direct and indirect compensation it will receive in connection with the assignment, any conflicts of interest and the services to be provided. If the arrangement does not fit the §408(b)(2) exemption from the prohibited transaction rules, including the new features that would be added by the proposal, the service-provider would owe excise taxes under §4975 of the Internal Revenue Code.<sup>1</sup>

In a separate proposal, the DOL would require fiduciaries of defined contribution plans with participant-directed investment to give the participants and beneficiaries uniform, basic disclosures about all of their investment options, including mutual funds, bank and insurance products, in a table to make comparisons easy. The table would show the fees and expenses (both plan-wide and individualized) associated with each investment, as well as performance data and comparable benchmark returns. The information would be provided to participants when they become eligible to participate in the plan and then annually. In addition, for each quarter, plan fiduciaries would be required to let participants know the various types (and amounts) of administrative expenses charged to their accounts during the preceding quarter.<sup>2</sup>

In a third related item of guidance, the DOL issued final regulations expanding the disclosure of service provider compensation on Schedule C of Form 5500 and requiring detailed disclosure of administrative and investment related fees.<sup>3</sup> These requirements, which are final, not proposed, are effective beginning with the 2009 plan year. Although the Schedule C to the Form 5500 for the 2009 plan year does not need to be filed until 2010, it will report on fees paid in 2009.

(To return to the discussion of the implications, click [here](#).)

<sup>1</sup> The proposed regulation, which was published in the December 13, 2007 *Federal Register*, is available on the following Web page: <http://www.dol.gov/ebsa/regs/fedreg/proposed/2007024064.pdf>

<sup>2</sup> The proposed regulation, which was published in the July 23, 2008 *Federal Register*, is available on the following Web page: <http://edocket.access.gpo.gov/2008/pdf/E8-16541.pdf> The DOL's model comparative chart is on page 30 of the PDF.

<sup>3</sup> The final regulations, which were published in the November 16, 2007 *Federal Register*, are available on the following Web page: <http://edocket.access.gpo.gov/2007/pdf/E7-21765.pdf>



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