



AMERICAN BENEFITS COUNCIL

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PARTICIPANT-LEVEL DEFINED CONTRIBUTION PLAN FEE DISCLOSURE: HIGHLIGHTS OF CHANGES IN FINAL REGULATIONS

[In order of appearance in final regulations; page references refer to preamble in preliminary text version at:

http://www.americanbenefitscouncil.org/documents/dol_401k-participant_finalreg101410.pdf]

1. Regulation under 404(a) (with corresponding changes in 404(c)) means applies to all participant-directed plans (not just 404(c) plans). (p. 4)
2. Compliance prior to regulation:
 - a. If 404(c) plan, compliance with Treas. Reg. Section 404c-1(b)(2)(i)(B) would have satisfied 404(a)(1)(A) and (B). (p. 7)
 - b. If not, DOL expresses no view as to the information that should have been furnished to participants and beneficiaries. (p. 7)
3. Plan administrator, as defined in ERISA Section 3(16), is responsible for complying with the rule's requirements. (p. 8)
 - a. However, a plan administrator will not be liable for the completeness and accuracy of information used to satisfy the disclosure requirements when the plan administrator reasonably and in good faith relies on information received from or provided by a plan service provider or the issuer of a designated investment alternative (moved from preamble to reg and issuer language added). (p. 9)
4. IRAs are not covered by the new rule. (p. 10)
5. New paragraph under plan related information requires a description of any "brokerage windows" or "self-directed brokerage accounts" or similar plan

arrangements that enable participants and beneficiaries to select investments beyond those designated by the plan. (p. 13)

- a. Also required to disclose any fees and expenses that participants will be expected to pay when utilizing the brokerage window or similar arrangement. (p. 13)
6. Several disclosures that were required on or by the date of plan eligibility under the proposed regulations are now required to be furnished on or before the date on which they can first direct their investments. (p. 14)
7. Notice of any changes to general information or administrative or individual expenses must be provided 30 to 90 days before the effective date with some very limited exceptions when such notice is not possible (dropping an inappropriate investment, for instance) when notice must be furnished as soon as practicable. There are significant changes here from the proposed regulations which only required notice on “material” change and required notice not later than 30 days after the date of adoption of the material change. (pp. 14-16)
8. Administrative expenses (not included in the annual operating expenses of designated investment alternatives) that may be charged against individual accounts must be disclosed quarterly and footnote specifically states that the final rule allows for aggregate disclosure of administrative expenses as proposed (no breakdown necessary). (p. 17)
 - a. New subparagraph requires that participants receive an explanation that, in addition to the expenses reported on the statement, some of the plan’s administrative expenses for the preceding quarter were paid from the annual operating expenses of one or more of the plan’s designated investment alternatives (e.g., through revenue sharing arrangements, Rule 12b-1 fees, sub-transfer agent fees) (pp. 17-18)
9. Individual expenses (expenses charged against a participant or beneficiary’s account on an individual, rather than a plan-wide basis but not included in the annual operating expenses of the investment) must be disclosed at least quarterly. These direct charge fees appear to include some fees from certain unregistered investment alternatives such as bank collective investment funds. The preamble also indicates that to the extent a charge is otherwise disclosed during a particular quarter, for example by a confirmation statement, the charge would not have to be disclosed again on a subsequent quarterly statement. (pp. 20-21)

10. Investment related information changes

- a. The final rule, like the proposal requires identification of the type or category of the investment but expanded the parenthetical examples to include investment alternatives that did not clearly fall within the list of examples included in the proposal. (p. 25)
- b. The requirement to disclose the type of management utilized by the investment (actively managed, passively managed) was eliminated in the final rule. (p. 25)

11. Performance data

- a. The proposed rule required disclosure of average annual total return of investments for 1-, 5- and 10-calendar year periods ending on the date of the most recently completed calendar year. The final rule adds “or for the life of the designated investment alternative, if shorter”). (p. 27)
- b. For investments with a fixed rate of return, the proposed rule required disclosure of the fixed rate of return and the term of the investment. The final rule requires disclosure of the current rate of return, the minimum rate guaranteed under the contract or agreement, if any, and a statement advising participants and beneficiaries that the issuer may adjust the rate of return prospectively and how to obtain (e.g., telephone or website) the most recent rate of return information available. (pp. 27-28)
- c. The final rule also clarifies that stable value funds and money market mutual funds are not treated as fixed return investments because fixed return investments are limited to investments with a fixed return with respect to which the investment risks are borne by an entity other than the participant (examples: CDs, GICs, variable annuity fixed accounts). (pp. 28-29)
- d. The final rule retains the proposed requirement that a benchmark must be a broad-based securities market index and it may not be administered by an affiliate of the investment issuer, its investment adviser, or a principal underwriter, unless the index is widely recognized and used. In response to comments, the DOL clarified that once the appropriate benchmark is provided for an investment that has a mix of equity and fixed income exposure (e.g., balanced funds or target date funds), the plan administrator can blend the returns of more than one appropriate broad-based index, provided the blended returns proportionally reflect the actual equity and fixed-income holdings of the designated investment. (p. 31)

12. Fee and expense information

- a. Must include a description of any restriction or limitation that may be applicable to a purchase, transfer or withdrawal of the investment in whole or in part (such as round trip, equity wash, or other restrictions). (p. 34)
- b. The final reg, like the proposed rule, requires disclosure of the total annual operating expenses of the investment expressed as a percentage (e.g., expense ratio) and adds a new requirement to provide an example illustrating the effect in dollars based on \$1,000 invested for a one-year period (assuming no returns and based on the total annual operating expenses). (pp. 34-35)
- c. The final rule also newly requires a statement that the cumulative effect of fees and expenses can substantially reduce the growth of a participant's or beneficiary's retirement account and that participants and beneficiaries can visit the Internet website of EBSA for information and an example demonstrating the long-term effect of fees and expenses. (p. 36)
- d. The final rule, like the proposal, requires all investment options to have a website address with additional information. However, the final rule clarifies that the supplemental information identified is the only information that must be provided but the plan administrator may provide additional information. (p. 39)
- e. The final rule also clarifies that, unless expressly exempted elsewhere in the rule, the information on the website must include the investment's portfolio turnover rate in a manner consistent with SEC form N-1A or N-3, as appropriate (the DOL exempted some investments such as fixed-return and employer stock). (p. 43)
- f. The final rule eliminated the requirement to disclose the "assets comprising the investment's portfolio" but added a new requirement to discuss the investment's principal strategies that includes "a general description of the types of assets held" by the investment. This narrative description is supplemented by more specific information available upon request. (p. 42)
- g. The final rule contains a new requirement that participants and beneficiaries be furnished, as part of the required comparative format disclosure document, information about how to request and obtain, free

or charge, a paper copy of the information required to be maintained on the website. (p. 45)

- h. The final rule requires that a general glossary of terms needed to understand the investment alternatives be provided to participants and beneficiaries either as part of the disclosure documents or on the website(s) if the web address is referenced with sufficient specificity along with a general explanation of the purpose of the address. The DOL also asks for comments on whether (and how) the DOL might develop a glossary that could be used by plans. (pp. 46-47)
 - i. Annuity options – the final rule adds two new provisions with requirements for disclosure in connection with annuity options and an appendix has been added to the Model Comparative Chart. (p. 47-50)
- 13. The proposed regulations indicated that required disclosure could be furnished in any manner consistent with the DOL’s electronic disclosure regulations. The final rule specifically reserves that section while further exploring whether, and possibly how, to expand or modify the standards applicable to the electronic distribution of required plan disclosures. The DOL stated they plan to publish a request for information on the topic in the near future and anticipates the resolution of the issue will occur in advance of the compliance date for this regulation (plan years beginning on or after November 1, 2011). (p. 56-57)
- 14. Total annual operating expense – The final regulations provide alternative methods of determining total annual operating expenses for some investment products including variable annuity products, bank collective investment funds, employer securities, annuities, and fixed return investments. The preamble indicates the DOL intends to publish a separate proposed rule dealing with target date and similar funds and has reserved a spot for it in the regulations. (p. 62-74)
- 15. The DOL reiterated its view that a fiduciary breach or an investment loss in connection with the plan’s selection or monitoring of a designated investment alternative is not afforded relief under Section 404(c) because it is not the result of a participant’s or beneficiary’s exercise of control. The DOL also added language in the regulation itself (some litigants have argued that the language in the preamble was not entitled to as much deference as language in the regulation itself). (p. 75)
- 16. The regulation is effective 60 days after publication in the Federal Register and applicable for plan years beginning on or after November 1, 2011. In addition, the initial disclosures required on or before the date on which a participant or beneficiary can first direct his or her investment must be furnished no later than

60 days after the rule's applicability date to participants and beneficiaries who had the right to direct investments on the applicability date. (p. 76)

17. The final rule also provides a transition period for non-registered investments for providing 5- and 10-year average annual total returns. For plan years beginning before October 1, 2021, if a plan administrator reasonably determines that it does not have the information on expenses attributable to the plan that is necessary to calculate the 5-year and 10-year average annual returns for a designated investment alternative that is not registered under the Investment Company Act of 1940, the plan administrator may use a reasonable estimate of such expenses (the plan administrator may use the most recently reported total annual operating expenses as a substitute if the plan administrator reasonably determines that doing so will result in a reasonable accurate estimate). (p. 77)