

**** UPDATE: As of February 3, 2012, the DOL has extended the 408(b)(2) effective date to July 1, 2012 and the 404(a) effective date to generally be August 30, 2012. See TCRS 2012-01 memo for details. ****

Date: October 25, 2010

TCRS 2010-07: Department Of Labor Final Regulations Relating To Participant Fee Disclosure

On October 20, 2010, the Department of Labor (DOL) published final regulations requiring participant-level fee disclosure in participant-directed individual account plans subject to the Employee Retirement Income Security Act of 1974 (ERISA). The final regulations were issued under ERISA section 404(a) with conforming amendments to ERISA section 404(c). These regulations establish uniform disclosures for participants (and beneficiaries) without regard to whether the plan is an ERISA section 404(c) plan. Generally, the final regulations retain the basic structure of the proposed regulations published on July 23, 2008, with a number of clarifications, modifications and some new provisions.

Under the final regulations, the investment of plan assets is a fiduciary act governed by the fiduciary standards of ERISA which require fiduciaries to act prudently and solely in the interest of plan participants and beneficiaries. Where the individual account plan permits participant direction of investments, the regulations provide that plan administrators have the responsibility for furnishing the required disclosures and for ensuring that participants, on a regular and periodic basis, are made aware of their rights and responsibilities with respect to the investment of their accounts. The regulations also require plan administrators to provide participants the information they need to make informed decisions with regard to the management of their accounts, including information regarding fees and expenses related to the plan and the plan's designated investment alternatives (alternatives).

Effective Date And Applicability Date

The regulations are effective December 20, 2010, and apply to covered plans for plan years beginning on and after November 1, 2011 (Applicability Date). For participants who had the right to direct the investment of their accounts on or before the Applicability Date, disclosures must be furnished no later than 60 days after the Applicability Date.

Covered Plans and Participants

The regulations cover only participant-directed individual account plans subject to ERISA such as 401(k), 403(b), and traditional profit sharing and money purchase plans. As such, it is not clear how the regulations apply to individual account plans that permit participant investment direction of certain contributions (e.g. elective deferrals) while other contributions, such as employer matching or nonelective contributions are directed by the plan trustee or fiduciary, although most plan administrators would probably conform to the final regulations with respect to all plan contributions regardless. Note, however, that fiduciary relief under ERISA section 404(c) is available only to investments directed by participants. IRA-based plans such as SIMPLEs and SEPs are not covered plans.

The final regulations apply to participants who have the right to direct investments, but also apply to employees who become eligible under the terms of the covered plan even though they elect not to defer or participate, and to beneficiaries who have the right to direct the investments in their accounts under the terms of the plan.

Two broad categories of information are required to be disclosed – plan-related information and investment-related information, discussed in more detail below:

Plan-Related Information

There are three sub-categories of plan-related information. Plan administrators are required to disclose: (i) general plan information regarding investments, (ii) plan-level administrative expenses charged to participant

accounts and (iii) individual expense information charged to participant accounts based on actions taken by the participant, rather than on a plan-wide basis.

- **General Plan Information**

General plan information must be disclosed on or before the date a participant can first direct investments and at least annually (once in any 12-month period) thereafter, based on the latest information available to the plan and include the following:

- Under what circumstances participants and beneficiaries may give investment instructions,
- Any specified limitations on such instructions, such as restrictions on investment transfers to and from an alternative,
- A description of or reference to the plan provisions relating to the exercise of voting, tender and similar rights associated with an investment in an alternative and any restrictions on such rights,
- Identification of any alternatives offered under the plan,
- Identification of any designated investment managers to whom participants and beneficiaries may give investment instructions; and
- A description of any brokerage windows, self-directed brokerage accounts or similar arrangements available under the plan. This requirement was added by the final regulations.

- **Administrative Expense Information**

Information regarding administrative expenses, to the extent such expenses are not included in the annual operating expenses of alternatives, must be furnished to a participant on or before the date the participant can first direct investments and at least annually thereafter and include:

- An explanation of any fees and expenses for plan administrative services (e.g. legal, accounting and record-keeping), that may be charged against the participant's accounts (whether by liquidating shares or deducting dollars), and the basis on which the fees and expenses will be allocated to each account (e.g. pro rata or per capita).
- At least quarterly (once in any 3-month period), a statement of the dollar amount of the fees and expenses actually charged during the preceding quarter and a description of the services to which the charges relate; and
- If applicable, a statement that some of the plan's administrative expenses for the preceding quarter were paid from the total annual operating expenses of one or more of the alternatives. This requirement was added in the final regulations to provide clarity for participants in plans that include a revenue sharing arrangement, 12b-1 fees and sub-transfer agent fees.

The DOL reiterated its position in the proposed regulations that administrative charges need not be broken down on a service-by-service basis.

- **Individual Expense Information**

Individual expense information relates to expenses that are assessed on an individual-by-individual basis, rather than on a plan-wide basis, based on actions taken by a participant, such as fees attendant to processing of plan loans, investment advice services, qualified domestic relations orders, front or back-end loads or sales charges, redemption fees and investment management fees directly charged to the participant's accounts.

At least quarterly, participants must be provided a statement that includes the dollar amount of the individual fees and expenses actually charged to participants' accounts during the preceding quarter and a description of the services to which the charges relate.

Investment-Related Information

Investment-related information must be provided to participants on or before the date the participant can first direct investments and at least annually thereafter, based on the latest information available to the plan, automatically and upon request.

Information To Be Provided Automatically

With respect to each alternative offered under the plan:

- **Basic Identifying Information**

- Name and category (e.g. money market, balanced, large-cap) of the alternative, and
- A website address that is sufficiently specific to lead participants to supplemental information, such as the name of the issuer or provider, the investment's principal strategies and attendant risks, the assets comprising the investment's portfolio, the portfolio turnover, investment performance and related fees and expenses.

The final regulations removed the requirement to disclose the type of management utilized by an alternative.

- **Performance Data**

For alternatives with respect to which the return is not fixed:

- The average annual total percentage return for 1-year, 5-year and 10-year periods (or for the life of the alternative, if shorter) ending on the date of the most recently completed calendar year, and
- A statement that past performance is not necessarily an indication of future performance

For alternatives with respect to which the return is fixed:

- The fixed rate of return,
- The term of the investment; and
- If the rate is subject to adjustment by the issuer, the current rate of return, any minimum guarantees, a statement that the rate is subject to adjustment and how to obtain the current rate of return (phone number or web site). This requirement was added by the final regulations.

- **Benchmarks**

For alternatives with respect to which the return is not fixed:

- The name and returns of an appropriate broad-based securities market index over the 1-year, 5-year, and 10-year periods (or for the life of the alternative, if shorter) comparable to the above performance data periods, and
- The alternative must not be administered by an affiliate of the investment provider, its investment adviser or a principal underwriter, unless the index is widely recognized and used.

The final regulations added a requirement to disclose historical performance for the life of an alternative. Benchmarking does not apply to alternatives with respect to which the return is fixed.

- **Fee and Expense Information**

For alternatives with respect to which the return is not fixed:

- The amount and a description of each type of shareholder fee (fees charged directly to participant accounts, such as sales loads and sales charges, deferred sales charges, redemption fees, surrender charges, exchange fees, account fees, purchase fees and mortality and expense fees, which are not included in the total annual operating expenses) and a description of any restriction or limitation on the purchase, transfer or withdrawal of the investment, such as equity wash or other restrictions,
- The total annual operating expenses expressed as a percentage (e.g. expense ratio),
- A statement that fees and expenses are only one of several factors participants and beneficiaries should consider when making investment decisions, and
- A statement that over the long-term, fees and expenses can substantially reduce the participant's accounts.

For alternatives with respect to which the return is fixed:

- The amount and a description of any shareholder type fees that may apply to a purchase, transfer or withdrawal of the investment (in whole or in part).

Fees and expenses may be expressed in terms of a monetary amount, formula, a percentage of assets or per capita charge. The DOL, in an effort to help participants better understand the significance of fees, added a requirement in the final regulations to also disclose total annual operating expenses as a dollar amount of a \$1,000 investment over a one year period.

Brokerage Windows

The regulations specifically exclude from the definition of “designated investment alternative” brokerage windows, self-directed brokerage accounts or similar arrangements. However, the regulations require that plan-related information and the fees participants are expected to pay when utilizing such arrangements be disclosed.

Special Rules

The final regulations include special rules for qualifying employer securities, annuities and fixed rate investments.

Most of the disclosure requirements do not apply to employer securities, but plan administrators must include a statement in the disclosure about the importance of diversification. Additional requirements apply when the employer securities are publicly traded or if participants acquire units of participation rather than actual shares.

Special rules also apply to investments with a fixed rate of return, such as certificates of deposit and guaranteed insurance contracts. For these investments, the fixed return provisions of the final regulations apply. Stable value and money market funds are not fixed investments under these regulations because they are not free of investment risk to the investor. Therefore, they are subject to the variable return provisions of the final regulations.

With respect to annuity options, the final regulations provide that variable annuity contracts are subject to the investment-related disclosure under the final regulations. It appears that deferred annuities providing for the purchase of a stream of current retirement income are not subject to investment-related disclosure requirements. Instead, the plan administrator must provide information regarding (i) the name of the option, (ii) the option’s goals or objectives, (iii) factors determining the price, (iv) limitations, fees or charges for withdrawals and transfers (v) fees that reduce amounts allocated to the option, (vi) a statement that the guarantees of the insurance company are subject to its long-term financial strength and (vii) an internet web site that contains all of the above information.

Deferred variable annuities are subject to the investment-related disclosures. It appears separate disclosures are required for other benefits, such as for a withdrawal benefit option.

Deferred fixed annuities appear to be subject to the disclosure for investments with a fixed return.

Comparative Format

For each alternative, investment-related information to be provided automatically is required to be disclosed in a chart or similar format designed to facilitate comparison by participants of the information across alternatives available under the plan. The chart must prominently display the date and must include: (i) a statement containing the name, address and phone number of the plan administrator (or someone acting on its behalf) for participants to contact for information to be provided upon request (see below), (ii) a statement that additional and more current investment-related information is available at a listed web site, and (iii) a statement on how to obtain a paper copy of the information about annuity options and fixed return investments. The plan administrator may include additional information provided it is not inaccurate or misleading,

The final regulations include a safe harbor model comparative chart that may be used by plan administrators to show performance-related and fee-related information. Plan administrators that use the model chart will be deemed to have satisfied the comparative format requirement of the final regulations.

Information To Be Provided Subsequent To Investment

After an investment is made, investing participants must be furnished materials provided by the plan relating to the exercise of voting, tender, or similar rights to the extent those rights are passed through under the terms of the plan.

Information To Be Provided Upon Request

The following information must be provided either (i) on or before the date on which the participant can first direct investments and at least annually, or (ii) upon request with respect to each alternative:

- Copies of prospectuses (or any short-form or summary prospectus) approved by the SEC, or similar documents provided by entities that are registered under either the Securities Act of 1933 or the Investment Company Act of 1940, or similar documents that are provided by unregistered entities,
- Copies of any financial statements or reports, such as statements of additional information and shareholder reports and other similar materials, to the extent provided to the plan,
- A statement of the value of a share or unit and the valuation date, and
- A list of the assets comprising the portfolio of each alternative which constitute plan assets and the value of each such asset (or the proportion of the investment it comprises).

Web Site Information

The final regulations require “sufficiently specific” information regarding each alternative to be made available to participants, through an internet web site (updated for changes as soon as reasonably possible after the change) and must include the name of issuer, objectives or goals¹, principal strategies and risks¹, portfolio turnaround¹, performance data updated on a quarterly basis (more frequently if required by other applicable law), and fee and expense information.

The final regulations assign the responsibility for ensuring the availability of a web site address to plan administrators, but to the extent issuers of alternatives and service providers have assumed responsibility for establishing and maintaining the web site, plan administrators will not be liable for the completeness and accuracy of the disclosure information if they reasonably and in good faith relied on the information.

Glossary Requirement

A general glossary of terms must be furnished to assist participants in understanding the alternatives or a web site address where the glossary can be found.

Manner and Timing of Disclosure

Plan-related information may be disclosed in the plan’s summary plan description or pension benefit statement, provided the timing of distribution meets the requirements for furnishing such plan-related information. Plan-level and participant-level fees may be included in pension benefit statements. All disclosure information must be written in a manner calculated to be understood by average participants. No specified format is required.

Disclosures must be provided on or before the date participants can first direct investments and annually thereafter. This was changed from the proposed regulations which required disclosures as of the date of plan eligibility. The 60-day transitional rule described above applies to the initial disclosure to be furnished to participants who have the right to direct investments on or before the Applicability Date.

The requirement to provide information on or before the date on which the participant can first direct the investment may be satisfied by furnishing the most recent annual disclosure and any updates furnished to satisfy disclosure of plan-related information. The requirement to furnish investment-related disclosures on or before the date on which the participant can first direct investments may be satisfied by providing the disclosure for investment information that is provided automatically.

¹ The final regulations mandate, among other things, disclosures regarding expenses attendant to alternatives as well as require that specific methods be used for calculating performance, portfolio turnover rate and portfolio strategies. These methods are set forth in various designated forms provided by the Securities and Exchange Commission (SEC) for registration of mutual funds and for separate accounts offering variable annuity contracts. While these forms are typically used for SEC-registered products, the final regulations require that the standards for narrative disclosure set forth in such forms are general enough that this information could also be used for all designated investment alternatives.

Updates to Disclosure Information

The final regulations require updating of plan-related information at least 30 days, but not more than 90 days, in advance of the effective date of the change, except for unforeseeable events or circumstances beyond the control of the plan administrator in which case, the updates must be furnished as soon as reasonably practicable. Unlike the proposed regulations which required only material changes to be disclosed, the final regulations require disclosure of all changes.

Notices of changes to investment-related information need not be furnished to participants more frequently than annually, but web site information should be updated as soon as reasonably possible following a change.

Revenue Sharing Arrangements

Specific disclosure related to revenue sharing arrangements are not required; however, if a plan has such an arrangement, the plan administrator must provide a disclosure statement that indicates that some of the plan's administrative expenses for the preceding quarter were paid from total annual operating expenses of the alternatives.

Reliance on Information Provided by Service Providers

The final regulations clarified that plan administrators will not be liable for reasonable and good faith reliance on information furnished by service providers with respect to disclosures to be provided automatically. In addition, this provision has been extended to enable reliance on information received from issuers of designated investment alternatives.

Electronic Media

The Preamble to the final regulations states that the DOL will be requesting comments on the suitability of electronic media to deliver the disclosures required by the final regulations and plans to issue guidance prior to the Applicability Date.

Target Date Funds

The final regulations do not include guidance on target date funds, but the DOL is expected to issue proposed regulations shortly.

This Summary is designed to provide an overview of the Department of Labor's Final Regulations relating to Participant Fee Disclosure and is not intended to be comprehensive. The Transamerica Center for Retirement Studies® ("The Center") is a non-profit corporation and private foundation. The Center may be funded by contributions from Transamerica Life Insurance Company and its affiliates or other unaffiliated third-parties. For more information about The Center, please refer to www.transamericacenter.org. The Center and its representatives cannot give ERISA, tax or legal advice. This material is provided for informational purposes only and should not be construed as ERISA, tax or legal advice. Interested parties must consult and rely solely upon their own independent advisors regarding their particular situation and the concepts presented here. Although care has been taken in preparing this material and presenting it accurately, The Center disclaims any express or implied warranty as to the accuracy of any material contained herein and any liability with respect to it.