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The Effects of the 401(k) Fair Disclosure and Pension Security Act of 2009 on Employers Sponsoring Defined Contribution Plans: "Enhanced Communications to Participants or More Compliance Pitfalls?"

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This article discusses how employers providing §401(k) plans to their employees will be affected by the 401(k) Fair Disclosure and Pension Security Act of 2009, legislation currently pending in the U.S. House of Representatives.

INTRODUCTION

On April 21, 2009, Representatives George Miller (D-Calif.) and Robert Andrews (D-N.J.) introduced the Fair Disclosure for Retirement Security Act of 2009 (H.R. 1984) and the Conflicted Investment Advice Prohibition Act of 2009 (H.R. 1988), respectively. These Bills were consolidated to create the 401(k) Fair Disclosure and Pension Security Act of 2009 (H.R. 2989).

H.R. 2989 was introduced to the House Education and Labor Committee on June 23, 2009. By a 29-17 party-line vote with Democratic support, the Committee voted that the Bill be reported the next day and sent to the House Ways and Means Committee.

Although Representative Miller's prior 401(k) Fee Disclosure Bill stalled in this Committee in 2007, the highly publicized effects on employees' retirement funds in the recent economic downturn will likely pressure representatives to support some type of 401(k) fee disclosure legislation. In addition, the shift from a Republican to a Democratic majority in the House may result in increased support, as

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Democrats have traditionally supported 401(k) fee disclosure legislation.

The Bill is divided into three Titles:

Title I, 401(k) Fair Disclosure for Retirement, would require the following:

- §401(k) service providers must disclose all fees to participants and beneficiaries and provide advance notice of fee changes;
- §401(k) service providers must provide information comparing investment options in a format easily understandable to the typical plan participant and beneficiary; and
- employees must have the option of investing in a passively managed index fund.

Title II, Prohibition of Conflicted Investment Advice, would require the following:

- investment advisers must be independent and may not receive compensation from the plan administrator (the employer) for their advice directly, nor can they enter into unrelated contracts for goods and services which may produce a conflict of interest; and
- employers must enlist in a program to be established by the Secretary of Labor educating employees about investment risks, debt, savings and the importance of preparing for retirement.

Title III, Transitional Funding Relief for Defined Benefit Plans, would allow the following:

- a party that elects to use a yield curve in lieu of a segmented interest rate in 2009 may revoke that election without the Secretary's consent in 2010; and
- miscellaneous recategorization of fees, extensions and minor amendments to ERISA and the Internal Revenue Code.

This article focuses on the fee disclosure and related investment provisions of Titles I and II of the Bill and does not address provisions set forth under Title III.

Effective dates for each subsection vary; some provisions would be effective on the day of enactment, some would take effect retroactively at the end of 2009, and others would not take effect for a year after enactment. In addition, some provisions would require the Secretary of Labor to create rules and guidelines within a certain period of time following enactment (usually 270 days), and parties would have to comply with those rules within a specified period of time.

Overall, this legislation would require investment managers and employers to provide extensive information to employees about the details of their §401(k) plans and ensure that investment advisers are ''independent.'' *Although some of these provisions target investment managers, employers should be aware of the requirements of the proposed legislation to protect the best interests of their corporate assets and the retirement savings of their employees.*

TITLE I — 401(k) FAIR DISCLOSURE FOR RETIREMENT

Section 401(k) Service Providers Must Disclose All Fees to Participants and Beneficiaries and Provide Advance Notice of Fee Changes; ERISA §111(a) (New)

In the words of Rep. Miller, ''in these difficult economic times, workers need simple and complete information in order to make better educated decisions about their retirement plans.'' [2] To achieve this goal, H.R. 2989 would mandate special reporting and disclosure rules for individual account plans that provide for participant choice among investment plans. The fee disclosure requirements discussed below would take effect one year after the enactment of the Bill. If the service provider fails to comply with these disclosure requirements, the provider could be fined up to $1,000 a day with respect to each violation every day the provider is not in compliance. The fine could not exceed 10% of the amount involved. Employers would not be subject to penalties for a service provider's failure to comply with these disclosure requirements.

What Plans Are Affected; ERISA §111(a)(10)(A)

The following fee disclosure requirements would apply only to plans subject to ERISA in which the total fees charged for services are reasonably expected to exceed $5,000 per year. The Secretary of Labor could adjust this total to a lesser amount for small plans or adjust this amount generally, as appropriate.

Service Disclosure Statement; ERISA §111(a)(1)

The employer could not enter into a contract for services to a §401(k) plan unless the employer received a statement specifying the services to be provided and expected annual charges, subject to the following requirements.

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[2] Comments of George Miller, 401(k) Fair Disclosure for Retirement Security Act 2009, available at *http://edlabor.house.gov/blog/2009/04/401k-fair-disclosure-for-retir.shtml*.

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Disclosure of Financial Relationships. The service disclosure statement must disclose any payment to be provided to the service provider for investment services provided to the employer's plan from any entity other than the plan or the accounts of the participants. This disclosure must also disclose any similar arrangements benefiting the service provider, including the extent to which the service provider may benefit from the offering of its own proprietary investment products or those of third parties.

Disclosure of Impact of Share Classes. This statement must also disclose that the share prices of certain mutual fund investments in the plan may be different from prices outside the plan due to different share classes.

Disclosure of Certain Arrangements in Connection with Free or Discounted Services or Reimbursements by Service Providers. If services are provided without any explicit charge, or for charges set at a discounted rate, the statement must specify the manner, extent, and amount by which consideration is otherwise obtained for those services.

Fee Disclosure Statements; ERISA §111(a)(2)

Under H.R. 2989, the plan administrator of an individual account plan (the employer) or any official acting on the employer's behalf would be required to demand a statement from the investment services provider with the following information.

Fees and Services. The statement must specify the services for the plan that will be provided and the expected total annual charges for these services, displayed prominently in a format understandable to the typical plan administrator.

Categorization of Fees. The statement must specify the component charges in the following categories:

(A) charges for administration and recordkeeping;

(B) transaction-based charges;

(C) charges for investment management; and

(D) all such charges not described in subparagraph (A), (B) or (C).

The charges in (A) and (C) must be presented in the written statement as an aggregate total dollar amount, and each of these total charges may also be presented as a percentage of assets. The charges in (B) must be itemized separately as dollar amounts or as percentages of the applicable base amounts.

Estimations. The service provider may provide a reasonable estimate of total annual charges based on the fees charged in previous years, or a reasonable estimate based on the plan's participants and beneficiaries. If the service provider provides this estimate, it must indicate that it is an estimate.

Updating. The service provider must provide to the plan administrator an updated statement containing fees and a description of the services provided. The service provider must issue a statement to the plan administrator describing any material change to fees or services "as soon as is reasonable after the occurrence of the change is known." This statement, or a statement indicating there have been no changes to fees or services, must be issued at least once a year.

Electronic Delivery Permitted

Any of the above disclosures could be provided through an electronic medium, which may be modified as the Secretary deems appropriate to accommodate new technologies and the interests of plan sponsors, service providers and participants.

Effective Date

New ERISA §111(a) would apply with respect to contracts or arrangements for services entered into after one year after the date of enactment.

Section 401(k) Service Providers Must Provide Information Comparing Investment Options in a Format Easily Understandable to the Typical Plan Participant and Beneficiary; ERISA §111(b) (New)

Unlike the fee disclosure statement discussed above, *employers — not investment managers — would be responsible for the following information if they sponsor plans that permit participant investment directions*. The employer or plan administrator would be required to disclose all available investment options to employees and include more information than previously required in quarterly benefit statements. These requirements would effect one year after the Bill's date of enactment.

Any employer or plan administrator that does not provide a statement to participants and beneficiaries in accordance with ERISA §§105(a)(2)(B)(ii) or 111(b) could be assessed a civil penalty of up to $100 a day during the period of noncompliance.

Disclosures to Participants and Beneficiaries: Advance Notice of Available Investment Options; ERISA §111(b)(1)

The employer would be required to provide employees with notice of the investment options before a reasonable period prior to the earliest date provided under the plan for the participant's initial investment of any contribution made on behalf of such participant and the effective date of any material change in investment options.

If the plan provides for immediate eligibility or an automatic contribution arrangement, this notice could

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be provided within any reasonable period prior to such initial investment.

Information Included in Notice; ERISA §111(b)(2)

This notice would be required to indicate which components of the charges are paid by the participant or beneficiary, and indicate how these charges are to be paid. The notice would also be required to set forth, with respect to each available investment option, the name of the option, a description, its risk level, whether the option is diversified, whether the option is actively or passively managed, and where to obtain more investment information. The notice would also be required to include a statement explaining that investment options should not be evaluated solely on the basis of its charges, but only on careful consideration of other factors such as risk, objectives, strategies and historical returns.

Plan Fee Comparison Chart; ERISA §111(b)(3)

The notice would also be required to include a plan fee comparison chart, comparing services and investment charges among different plans. The chart would have to be easily understood by the typical participant, and include further information as the Secretary deems necessary for participants and beneficiaries to assess the services and charges. The chart would have to present fees in dollar amounts, or as a formula, such as a percentage of assets in a manner easily understandable to the typical participant.

The chart would be required to list the charges in the following categories, which are slightly distinct from the categories of the fee disclosure statement: asset-based charges specific to investment, asset-based charges not specific to investment, administrative and transaction-based charges, and all other charges. The charges would have to be further described, however, indicating the extent to which each charge is for investment management, transactions, plan administration and recordkeeping, or other identified services.

In addition, the chart would be required to specify (as amounts or percentages) the fees assessed in connection with the option and the historical return and net fees and expenses. The investment manager could provide an estimate for fees and charges, but this would not be required. If the provider issues an estimate, however, it must disclose the basis of its assumptions.

Electronic Delivery Permitted

Any of the above disclosures could be provided through an electronic medium, which may be modified as the Secretary deems appropriate to accommodate new technologies and the interests of plan sponsors, service providers, and participants.

Quarterly Benefit Statements; ERISA §105(a)(2)

The Bill would amend ERISA §105, which would require quarterly benefit statements to provide the following information:

- the starting balance of the account;
- contributions made during the quarter, itemizing separately totals for employer and totals for employee contributions;
- investment earnings or losses during the quarter;
- actual or estimated charges that reduce the account during the quarter in dollars or as an expense ratio;
- any other direct charges to the participant or beneficiary;
- the ending balance;
- the participant's asset allocation to each investment option, expressed as an amount and as a percentage; and
- how to obtain the most recently updated version of the plan fee comparison chart.

If the plan has 100 or fewer participants and beneficiaries, the plan could provide the pension benefit statement on an annual rather than a quarterly basis.

Other Information

The plan administrator (the employer) could include other information in the quarterly pension benefit statement, such as a reasonable estimate of charges or percentages, and would have to indicate any estimate as being an estimate, based on reasonable assumptions included in the statement.

Assistance to Small Employers (100 or Fewer Employees)

The Secretary would be required to make available to small employers education and compliance materials and services designed to assist these employers in finding affordable investment options. The Secretary would also be required to provide materials that compare investment performance and charges for these options on an ongoing basis.

Assistance to Plan Sponsors and Plan Participants and Beneficiaries

The Secretary would be required to provide assistance to plan sponsors and beneficiaries with any questions regarding compliance with the above requirements.

Electronic Delivery Permitted

Any required disclosure could be provided through an electronic medium.

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Effective Dates

New ERISA §111(b) would apply with respect to plan years beginning after one year after the date of enactment. The amendments to ERISA §105 would apply with respect to pension benefit statements for calendar quarters beginning after one year after the date of enactment. Section 101(c) of the Bill would amend ERISA §502.

Good Faith Compliance Prior to Secretary's Regulations

The Secretary would be required to issue final regulations under new ERISA §111 not more than 270 days after the date of enactment. Any act or practice in advance of the issuance of final regulations under these amendments that is in good faith compliance with the requirements of these amendments would be treated as compliance with any final regulations.

The Employer Must Ensure That Employees Have the Opportunity to Invest in a Passively Managed Index Fund; ERISA §404(c)(6) (New)

With respect to employers sponsoring plans with participant-directed investments and that seek fiduciary relief under ERISA §404(c) concerning the investment choices made by those participants, the proposed amendments to ERISA would require plan providers to include a passively managed investment fund as an investment option ''designed to be representative of the United States investable equity market (including representation of small, mid, and large cap stocks) or the United States investment grade bond market (including Treasury, agency, non-agency, and corporate issues) or a combination thereof.'' This investment option would have to be described in the terms of the plan as offered without any endorsement of the government or plan sponsor. Failure to include this investment option would be considered a forfeiture of the fiduciary protection from a participant's exercise of investment discretion provided in ERISA §404(c).[3]

The provision would apply for plan years beginning after one year after the date of enactment, and the Secretary would be required to issue regulations in accordance with this provision not more than 270 days after enactment. Good faith compliance in advance of the regulations would be treated as compliance with any final regulations.

[3] ''[N]o person who is otherwise a fiduciary shall be liable under this part for any loss, or by reason of any breach, which results from such participant's or beneficiary's exercise of control . . . .'' ERISA §404(c)(1)(A)(ii).

Enforcement Coordination and Review by the Department of Labor; ERISA §502(n) (New)

The Bill would require the Secretary to notify the applicable regulatory authority in any case in which the Secretary determines that a service provider is engaged in a pattern or practice that precludes compliance by plan administrators and take timely enforcement action to assure that the pattern or practice ceases and desists. The Secretary would also be required to widely disseminate to employee pension benefit plans and their participants and beneficiaries the identity of any service providers found to be noncompliant with the intent to preclude compliance by plan administrators with ERISA §111 and the particulars of such pattern or practice.

The Bill would also require the Secretary to annually audit a representative sampling of individual account plans to determine compliance.

TITLE II — PROHIBITION OF CONFLICTED INVESTMENT ADVICE

The Bill would repeal ERISA §408(g), add new ERISA §§3(43) and 404(a)(3), and amend ERISA §516. These amendments would apply to plan years beginning after one year after the date of enactment.

This Title does not specify penalties for noncompliance.

Research Findings

Title II of the Bill begins with a summary of research findings that presumably justify these legislative enactments. The legislation reports that, in 2007, the Government Accountability Office concluded that conflicts of interest can have an adverse effect on defined benefit and defined contribution plans. This research reports that $2 trillion of Americans' retirement savings was wiped out over a 15-month period, beginning in 2008, with individual average losses of §401(k) plan participants ranging from 7.2% to 11.2% in the past nine months. This legislation targets conflicts of interest between employers and §401(k) plan providers.

Independent Investment Advisers for Individual Account Plans

The Bill would define ''independent investment adviser'' as a person who is a fiduciary of the plan by reason of the provision of investment advice referred to in ERISA §3(21)(A)(ii) by the person to the plan or a participant or beneficiary of the plan. An investment adviser would meet these requirements if he or she is

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registered under the Investment Advisers Act of 1940 (15 USC §§80b-1 et seq.) or under the laws of the state in which the adviser maintains its principal office and place of business. An adviser may also be a bank referred to in ERISA §408(b)(4) or a savings association, as defined under §3(b)(1) of the Federal Deposit Insurance Act, 12 USC §1813(b)(1), but only if this advice is provided through a trust department of the bank or similar financial institution that is subject to periodic review by federal or state authorities.

The adviser could not be the plan investment provider. In addition, the compensation received, directly or indirectly, for investment advice could not be received from any party or anyone affiliated with a party that markets, sells, manages or provides investments in which plan assets of the account plan are invested. Compensation could not vary depending on the basis of any investment option selected. Compensation would be calculated pursuant to a flat-dollar basis, a flat percentage of total plan assets basis, a flat or sliding scale percentage of the assets in an account basis, or a per-participant or per-beneficiary account basis.

The adviser would be required to provide the investment advice pursuant to a written arrangement that:

- provides that the investment adviser is a fiduciary of the plan with respect to the provision of the advice;
- requires that the advice be provided only by registered representatives of the investment adviser or an affiliate thereof;
- discloses, before a reasonable period prior to entering this arrangement, whether the adviser has any relationship with a money manager, broker, other client of the investment adviser, other service provider of the plan, or any other entity that may create a conflict of interest for the investment adviser;
- includes a representation by the investment adviser that, before the arrangement was entered into (or extended or renewed), the adviser provided to the plan fiduciary that has authority to cause the plan to enter into (or extend or renew) the arrangement a written statement disclosing all fees or other compensation that the investment adviser or any affiliate anticipates to receive with respect to the advice during the first year, or other period if less than a year; and
- provides that the investment adviser will provide to the plan fiduciary (and the participant and beneficiary receiving the advice, if applicable) a statement annually disclosing all fees or other compensation that the investment adviser or any affiliate has received with respect to the advice during the prior year; and
- provides that the terms of the arrangement and certain above information be furnished by the investment adviser to the participant or beneficiary that is the recipient of the advice.

Effect on Pre-PPA "SunAmerica" Arrangements [4]

"SunAmerica arrangements," are arrangements allowing financial institutions to provide certain investment advice through a computer model developed and administered by an independent financial expert. The arrangement was named after the Department of Labor's Advisory Opinion to SunAmerica in 2001. (DOL Adv. Op. 2001-09A) In this opinion, the DOL approved an investment advisory program in which the investment recommendations are under the control of an independent financial expert. In 2006, the Pension Protection Act (PPA) amended ERISA by creating the concept of an "eligible investment advice agreement," which included so-called SunAmerica arrangements.

In the "11th hour," Democrats on the House Education and Labor Committee deleted the provision that would have made clear the legislation would not preempt SunAmerica arrangements. The legislation now prohibits these arrangements, thereby barring financial institutions from providing investment advice to a plan if they also offer investment products to the plan, with the following two exceptions.

First, SunAmerica arrangements would be permitted if the independent party that develops the computer model accepts fiduciary responsibility for the advice provided to the participants and meets certain other conditions, such as receiving level fees and not providing or managing any defined contribution plan assets. This occurs under some SunAmerica arrangements but not in many others in which the third party does not have a contractual relationship with the plan.

Under the second exception, SunAmerica arrangements would be permitted if the arrangement is modified to comply with PPA computer model requirements, including (1) taking into account all investment options under the plan; (2) in some cases, taking into account non-retirement plan assets; (3) certification by an independent expert and annual audits; and (4) eliminating any managed account feature.

The American Benefits Council has noted that this legislation would prohibit a large number of existing

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[4] Analysis of this section of the statute incorporates the comments of the American Benefits Council. *See* American Benefits Council, *Comments on H.R. 1988: The Conflicted Investment Advice Prohibition Act of 2009* (June 1, 2009), available at *http://www.americanbenefitscouncil.org/documents/inv_advice-hr1988comments.pdf*.

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investment advice arrangements that were developed based on pre-PPA laws and that do not involve conflicted advice. Additionally, it is expected that this provision would require costly modifications to computer models and may, in some cases, make advice arrangements less effective.[5]

Employers should be on notice of whether the investment advice provided to them and their employees is based on a computer model that falls into the category of a SunAmerica arrangement. Under the legislation, such a model will most likely be prohibited in its current form unless it is altered to fall into one of the two exceptions provided.

Fiduciary Duties with Respect to Investment Advice

The fiduciary of an individual account plan could appoint only independent investment advisers to provide investment advice. This adviser would be required to provide, within a reasonable period prior to providing advice, a written notification comparing the past performance and historical rates of return of the investment options available. The investment adviser would also be required to notify the beneficiary and participant that he is acting as a fiduciary of the plan in connection with his advice.

Notwithstanding this requirement, the plan sponsor or any person who is a fiduciary would not be exempt from prudent selection and periodic review of an independent investment adviser. This provision would provide only that a plan sponsor may reasonably rely on an adviser's representation that he or she meets the requirements of an ''independent adviser.'' The plan sponsor and any other fiduciary would have no duty to monitor the specific investment advice given by the adviser and would *not* be liable for any loss, or by reason of any breach, which arises from the investment advice given by the adviser. Plan assets could be used to pay for reasonable expenses in providing investment advice.

These amendments would apply to plan years beginning after one year after the date of the enactment.

This provision would not apply to SunAmerica arrangements or any other arrangement that meets the requirements of any Department of Labor advisory opinion. The statute would allow the Secretary of Labor to prescribe rules for these investment advice arrangements.

Report on Prior Advisory Opinions and Exceptions

The Secretary of Labor would be required to review each advisory opinion, determine whether it adequately serves the interests of participants and beneficiaries, and submit a report to each house of Congress describing the extent of any failings.

Regulatory Authority

The Secretary of Labor could issue regulations providing that an investment adviser can still be classified as an ''independent adviser'' despite the receipt of a de minimis amount of compensation.

Expansion of Outreach to Promote Retirement Income Savings to Include Promotion of Education on Financial Literacy with Respect to Investment for Retirement

Under revised ERISA §516, the Secretary of Labor would be required to establish a program that provides employees with materials:

- informing them about resources available for attaining financial literacy;
- educating them about the importance of saving for retirement and choosing independent investment advisers; and
- educating them about the relationship between debt and savings.

Employers would be enlisted to participate in a program that meets the education goals described above. The Secretary would be required to conduct a survey of the ongoing efforts by the federal government to assist employees in improving their financial literacy. The Secretary would be required to submit a report with these findings and its educational programs within 180 days of the date of enactment.

CONCLUSION

Past efforts to pass §401(k) fee disclosure legislation have failed. However, the recent economic downturn may provide lawmakers with the springboard they need to push this bill through both houses of Congress. Undisclosed §401(k) fees may not be the cause of recent events in the financial industry, but lawmakers have utilized the publicity from recent events to rally support for this Bill. If this Bill becomes law, employers must ensure that all §401(k) statements meet these more stringent disclosure requirements, and investment advisers will be considered ''independent'' under these provisions.

A reader may question whether this additional disclosure (given the complexity of the new requirements) may lead to more confusion among participants, rather than more clarity. If that is the case, then

[5] *Id.*

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less retirement savings may result. However, if the bright light of disclosure brings to an end certain inappropriate fee sharing arrangements and conflicted investment advice, then worthwhile goals will have been achieved. Of course, though the ultimate impact of the legislation on retirement savings may be unclear, the burden on employers and plan service providers will undoubtedly increase in making certain that the new statutory requirements (if enacted) are met.

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