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Dawning of a New Era

Participant-level fee disclosure—the culmination of a journey

This year, the final week of August signified something more than the annual Labor Day weekend prelude. Beginning August 31, a new information era dawned for participants in self-directed plans. The administrators of most plans, including all calendar-year-based plans, became obligated to provide disclosures of plan and investment-related information to participants in the manner required by the final Department of Labor (DOL) participant-level disclosure regulation, codified at 29 CFR § 2550.404a-5. The first quarterly disclosures required by the regulation with respect to fees and expenses actually deducted from accounts will be due on November 14 (45 days after the close of the September 30 quarter-end).

The participant-level disclosure regulation is the third, and final, piece of the DOL's multiyear project to redesign the reporting of fees and expenses by and to Employee Retirement Income Security Act (ERISA) plans. This new three-legged stool of fee reporting rests on the redesigned Form 5500 Schedule C instructions, the 408(b)(2) plan-sponsor-level fee reporting regulation and the participant-level 404(a)(5) participant disclosure regulation. While questions will remain concerning the application and interpretation of certain elements of the new rules, the "heavy lifting" involved in changing systems and processes to comply is now largely behind us.

In many respects, the participant disclosure regulation is an important departure from a prior regulatory tendency to smother participants with voluminous information that was not only extremely costly to generate and deliver but was also of questionable usefulness to most participants—the prospectus delivery requirement under the original 404(c) regulation being a great example. The layered approach taken by the participant-level disclosure regulation crystallizes plan investment option expense ratios, fixed interest rates of return and performance information in a precalibrated snapshot that most engaged participants should find relatively easy to use. At the same time, the regulation preserves participants' ability to do further analysis by accessing more in-depth, detailed information through designated Web addresses, while avoiding the extremely significant cost and expense of a paper-based disclosure regime.

The regulation also recognizes that the nature and content of the information that participants need for making decisions about the investment of their plan account balances fundamentally differs from that information required by plan fiduciaries for purposes of engaging plan service and investment providers. Where the general costs of plan administration are covered by revenue sharing, the regulation requires that participants be informed of that fact and reminded on a quarterly basis that the expenses of plan administration are reflected in the total annual operating expenses of one or more of the plan's designated investment options. Participants are also informed about the plan-level charges against their account balance where no revenue-sharing arrangements are used or are only partially available to offset the costs of plan administration.

Some have leveled criticisms that the current regulation should be expanded to include more detailed revenue-sharing disclosures, including which of the plan's designated investment alternatives provide revenue-sharing support—and how much support—as well as which ones provide none. Those critiques are best tested by considering whether the additional disclosures would be likely to drive more favorable participant outcomes. Not only are more favorable outcomes unlikely but additional revenue-sharing disclosures at the participant level could actually be counterproductive, by promoting irrational investment decisions. Where revenue-sharing arrangements are used to support recordkeeping and administration, it is typically the case that certain investment alternatives provide greater degrees of support than others. Disclosure of those differences at the participant level could drive investment behavior that would favor investing in funds that pay little or no revenue sharing while avoiding those that do, irrespective of their relative merits as investments.

The primary challenge that participants face remains allocating their account balances wisely among the investment alternatives available under the plan. The approach taken by the regulation assists in meeting that challenge with layered disclosures, to properly avoid the unnecessary confusion that would accompany complex, 408(b)(2)-style revenue-sharing disclosures at the participant level.

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