

# Deferred Compensation Plan BOARD REPORT 12-32

Date: June 8, 2012  
To: Board of Deferred Compensation Administration  
From: Staff  
Subject: Department of Labor Fee Disclosure Requirements

*Board of Deferred  
Compensation Administration  
Eugene K. Canzano, Chairperson  
John R. Mumma, Vice-Chairperson  
Cliff Cannon, First Provisional Chair  
Tom Moutes, Second Provisional Chair  
Sangeeta Bhatia, Third Provisional Chair  
Michael Amerian  
William Raggio  
Robert Schoonover  
Margaret M. Whelan*

## **Recommendation:**

That the Board of Deferred Compensation Administration a) receive and file the following information regarding new federal rules for Plan fee disclosures, and b) approve staff's recommendations to voluntarily comply with the new rules as a matter of best practice by:

- (1) Providing all current Plan participants with an annual notice regarding fees in the Plan's quarterly statement to be issued in July 2012;
- (2) Providing all eligible employee non-participants with an annual notice regarding the Plan and its fees, along with information marketing the benefits of the Plan, by August 30, 2012;
- (3) Providing all Plan participants with required quarterly notice information prior to the implementation deadline of November 14, 2012; and
- (4) Formally request that the Plan's subject service providers disclose all direct and indirect compensation they derive from their service to the City's Plan.

## **Background:**

The Department of Labor (DOL) recently released two sets of rules governing fee disclosure in retirement plans. The intent of these rules is to ensure that investment and retirement plan fees are adequately disclosed to plan participants and plan sponsors.

These rules are compulsory only for retirement plans covered by the Employee Retirement Income Security Act (ERISA). As an Internal Revenue Code Section 457 governmental plan, the City's Deferred Compensation Plan is not covered under ERISA and therefore not subject to the rules. However, generally speaking most governmental plans attempt to follow ERISA and DOL guidelines as a best practice. With respect to this issue, according to a recent NAGDCA survey, 94.2% of public plans indicated that they intended to voluntarily comply with the new fee disclosure rules.

The rules involve two fundamental requirements and implementation deadlines for subject ERISA plans:

- (A) Disclosure of certain fee information *from a plan sponsor to plan participants and eligible employees* via an annual notice to be initiated by August 30, 2012; and ongoing quarterly notices to be initiated by November 14, 2012; and
- (B) Disclosure of certain fee information *from service providers to plan sponsors* to be initiated by July 1, 2012.

Staff has been working with the Board's Plan Administration consultants at Mercer and Great-West Retirement Services to review the requirements of the rules and how they might be implemented in the City's Plan. Mercer has provided the Board with summary information regarding the rules (Attachment A). Great-West communicated to Mercer as well as to staff that it is planning to implement the requirements for its ERISA plan sponsors first by the relevant implementation deadlines, and was deferring until later in 2012 any non-ERISA plans wishing to voluntarily comply. Great-West's efforts are focused on creating a uniform approach to disclosure that will work across its broad client base. This client base is diverse with respect to existing fee structures and communication of those fees, and therefore Great-West's interest in establishing a standardized reporting option and deferring implementation for non-ERISA plans certainly makes sense from their perspective. However, staff has identified some alternatives which would allow the City's Plan to be more proactive, implementing good-faith voluntary compliance efforts and doing so more rapidly than will be the case with Great-West's other clients.

Staff will address each rule separately, including recommendations regarding how to proceed with good faith efforts to voluntarily comply.

***Plan Sponsor to Participant/Eligible Member Fee Disclosure  
DOL Regulation Section 2550.404a-5***

This regulation concerns fee disclosure to be provided from plan sponsors to participants and eligible employees. There are two parts to this rule, one involving an annual notice and the second involving quarterly notices.

Annual Notice - For ERISA plans, the initial annual notice is due August 30, 2012 to all eligible employees (all participants under the plan as well as non-participants who are eligible to join) and to terminated employees or beneficiaries with account balances. This notice is required annually thereafter.

The annual fee notice must include: (1) general plan information and service descriptions; (2) plan administrative expenses and other expense information; (3) performance returns and benchmark data; and (4) investment expense information.

For its client base generally, Great-West indicated it is proceeding to package this as a special mailing, the costs of which would be charged back to the client at a rate of \$1.50 per participant. However, staff's finding is that the same information can be provided relatively easily through the Plan's quarterly newsletter without incurring the additional cost. The essential disclosure elements (general plan information, administrative/investment costs, and performance data) is already well-developed within existing communication materials and the quarterly statement, and need only be consolidated or slightly modified to meet the new requirements. Staff is therefore recommending that the first annual disclosure be provided to participants via the July,

2012, quarterly newsletter. This would demonstrate good-faith voluntary compliance with the rule for all current Plan participants.

As noted above, the annual notice is also required for all non-participating eligible employees. There are approximately 13,000 such employees in the City's Plan. Staff believes that communication of this information would provide an excellent opportunity to market the Plan to non-members through a direct mailing. As a result, staff recommends that the Board approve providing all eligible employee non-participants with an annual notice regarding the Plan and its fees, with this information to be packaged within the format of a general invitation to enroll and learn about the benefits of the Plan, by August 30, 2012.

Quarterly Notice - For ERISA plans, the initial quarterly notice is due November 14, 2012, to all participating employees and terminated employees or beneficiaries with account balances, and is required thereafter once every three months (quarterly). This notice differs from the annual notice by including administrative and individual charges actually charged to individual participant accounts. Since the City's statements already include itemization of dollar charges against participant accounts, our expectation is that virtually all of the required information is already being provided, and that only a slight modification to the performance returns table may be required. Staff will be reviewing this in greater detail in advance of the next quarterly statement to be issued in October 2012. As a result, staff recommends that the Board approve making the minor adjustments necessary to provide all Plan participants with required quarterly notice information prior to the implementation deadline of November 14, 2012.

***Service Provider to Plan Sponsor Fee Disclosure  
DOL Regulation Section 2550.408b-2***

This regulation concerns disclosure requirements to be provided by covered service providers to plan sponsors. Covered service providers generally include recordkeepers, consultants, trustees, fiduciaries to plan asset vehicles, brokers, and other providers receiving indirect or related compensation. Mutual funds are not subject to the disclosure rules in any circumstance (including for ERISA plans), presumably because of well-established fee reporting requirements already provided for under separate Federal regulations.

Subject service providers need to provide written descriptions of services provided to the plan and disclose direct and indirect compensation received, compensation paid among related parties, and related investment fees and expenses. This rule is effective July 1, 2012 and disclosures must be updated whenever contract terms or fees change.

Staff has determined that voluntary compliance with this rule would involve disclosures from, minimally, the Plan's third-party-administrator and consultant; and potentially investment managers for the Plan's separate account, commingled fund, and banking institutions. The required fee information should already be contained within existing contracts and related documents, but staff recommends that the Plan's subject service providers be requested to separately disclose all direct and indirect compensation they derive from their service to the City's Plan. This would document the Plan's efforts at good faith voluntary compliance with this rule. Staff's intent would be to solicit the Plan's service

providers for this information immediately and then report back at the Board's July 17, 2012 meeting.

**Conclusion:**

Improved fee disclosure is a laudable goal and one consistent with long-standing efforts on the part of the Board and the City's Plan to ensure that all fees are transparent to and easily understood by Plan participants. The DOL requirements create opportunities to make further improvements in fee disclosure, provide education regarding the Plan, and encourage enrollment amongst current non-participants. On that basis staff believes there is value in not only voluntarily complying with the new rules but doing so as expeditiously as possible.

Going forward, there may be additional refinements to the manner in which this information is provided. Staff will continue to report to and seek direction from the Board as these refinements are considered.

Submitted by: \_\_\_\_\_  
Esther Chang

\_\_\_\_\_  
Steven Montagna

Approved by: \_\_\_\_\_  
Alejandrina Basquez

## MEMO

**TO:** Steven Montagna, City of Los Angeles  
**DATE:** May 22, 2012  
**FROM:** Andrew Ness, Beverly Orth  
**SUBJECT:** DOL Fee Disclosure Requirements

### Overview

Two sets of new Department of Labor rules will apply to ERISA covered retirement plans beginning in 2012:

- DOL Reg. Sec. 2550.408b-2 (the “service-provider disclosure regulation”) requires certain “covered service providers” (CSPs) to furnish specified information to retirement plan fiduciaries regarding the CSPs’ compensation from the plan.
- DOL Reg. Sec. 2550.404a-5 (the “participant-level disclosure regulation”) requires plan sponsors to disclose certain plan and investment-related information (including fee and expense information) to participants and beneficiaries in “participant-directed” individual account plans.

While governmental 457 plans are not subject to ERISA, some larger plans wish to understand the extent to which their CSPs will meet these disclosure requirements as a matter of best practice.

### Service-Provider Disclosures

- Rules are effective July 1, 2012
- Apply to existing contracts/ arrangements as of July 1, 2012, and to all new or renewed contracts/ arrangements entered into thereafter
- Disclosures must be updated whenever contract terms or fees change (i.e., it is not an annual requirement)
- Compensation thresholds (i.e., disclosures not required if below these amounts):
  - \$1,000 or more expected over length of relationship (not the contract term)
  - \$250 or more for non-monetary compensation expected over contract term
- Categories of “covered service providers” include:
  - Recordkeepers
  - Investment consultants
  - Trustees

- Fiduciaries to “plan asset vehicles” (e.g., collective or group trusts, hedge funds, private equity funds, insurance company separate accounts)
- Brokers receiving commissions
- Other providers receiving “indirect” or “related-party” compensation
- Rules apply only to CSPs who receive:
  - Direct compensation (paid from plan assets or participant accounts);
  - Indirect compensation; or
  - Related-party compensation
- Disclosure rules are enforced through ERISA and Internal Revenue Code prohibited transaction rules (i.e., excise taxes and potential civil penalties)

### **Participant-Level Disclosures**

- First annual notice is due August 30, 2012, to all employees (whether or not participating) and terminated employees or beneficiaries with account balances
  - Notice contains general plan information, administrative expenses, description of individual fees and expenses (i.e., loan fees or other transaction based fees), and comparative chart of investment options
  - Distribute annually thereafter
  - Distribute to new hires before they enroll
- First quarterly notice is due November 14, 2012, to all participating employees and terminated employees or beneficiaries with account balances
  - Notice contains actual administrative and individual charges assessed to account
  - Thereafter, once every 3 months, and may be included with quarterly participant statements
- Other disclosures
  - Voting/ tender rights (and other pass-through information) following employee’s actual investment in a fund
  - Detailed investment materials and comparative chart of investment options
  - No requirement to separately disclose revenue sharing amounts but must provide general explanation of the practice (if applicable)

### **Great-West Disclosure Content and Timeline**

Great-West intends to assist public sector 457 plan clients that wish to meet the fee disclosure requirements. Below are their high-level plans for implementation.

The determination of whether a disclosure is adequate is a fiduciary determination by the City. Mercer has reviewed the samples provided and has included commentary to assist with the determination.

- End of July 2012: City is expected to receive plan-level disclosure document electronically. Sample disclosure provided appears to satisfy 2550.408b-2 requirements, but the actual disclosure document should be reviewed following delivery. (See draft "Fee Disclosure – National Accounts Sample")
- August 2012: City will receive an election form from Great-West. The City will determine if it wishes to have Great-West mail the annual participant-level disclosure document. Cost will be \$1.50 per participant per year.
- Great-West does not have mailing addresses for eligible employees who are not enrolled in the DCP. If the City wishes to comply with this portion of the disclosure rules, Great-West can provide a disclosure document that can be distributed by the City.
- November/ December 2012: Great-West will deliver the participant-level disclosure document to all participants on the recordkeeping system. Annual notice will be delivered in fourth quarter of each year. Sample disclosure provided appears to satisfy 2550.404a-5 requirements. (See "Investment Returns & Fee Comparison as of 8/31/2011") Actual disclosure for City's plan should be reviewed for compliance when draft is available.
- Quarterly participant notices: Required information will be included on quarterly participant statements beginning with the December 31, 2012, statement. Sample statement provided appears to satisfy 2550.404a-5 requirements, but should be reviewed following development. (See "Retirement Plan – Fee Sample")

## **Conclusion**

- Great-West intends to comply voluntarily for governmental plans even though they are not legally subject to the DOL requirements.
- Timing will be slightly behind the legally required timing for ERISA plans.
- Sample disclosures provided appear to satisfy the disclosure requirements but will need further review after development.