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Retirement Plan Fiduciaries Need to Comply with Fee Disclosure Regulations Soon

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A FREEBORN & PETERS WHITE PAPER

ABOUT THIS WHITE PAPER

This white paper explains new regulations for retirement plan fiduciaries that will come into effect in 2012 and outlines steps that can be taken towards compliance.

In recent years, plan participants and the government have examined issues surrounding the reasonableness of retirement plan service provider fees. In the aftermath of several lawsuits filed by plan participants, the United States Department of Labor promulgated two sets of fee disclosure regulations that address some of the issues raised by the plaintiffs in those suits. The regulations are scheduled to go into effect soon and, as a result, plan fiduciaries need to ramp up their compliance efforts to ensure that their plans meet the requirements on a timely basis.

The 408(b)(2) Regulations

The first set of fee disclosure regulations is known as the 408(b)(2) regulations or the "service provider fee disclosure" regulations. These regulations require a service provider to disclose certain information to the plan sponsor. They are effective July 1, 2012, for all contracts or arrangements in existence on that date and all future contracts and arrangements. If the plan administrator does not comply with the 408(b)(2) regulations, the service arrangement will become a prohibited transaction, which may result in excise taxes and ERISA enforcement action on the basis that the contract or arrangement is not reasonable.

Prior regulations said very little as to what constitutes a reasonable contract or arrangement, but the 408(b)(2) regulations generally require a "covered service provider" of services to a "covered plan," who receives direct or indirect compensation from that plan, to disclose certain information to plan fiduciaries. It is important to note that the 408(b)(2) regulations do not apply if the service provider is paid by the plan sponsor and does not receive any direct or indirect payments from the plan. Thus, a service provider retained by the plan sponsor and paid entirely by the plan sponsor is not covered by these regulations. If there are no plan assets involved, the regulations do not apply.

A "covered plan" is any "employee pension benefit plan" or a "pension plan" as defined by ERISA. It includes 401(k) plans and defined benefit pension plans. It does not include IRAs, plans maintained solely for the benefit of self-employed individuals, government plans, non-ERISA 403(b) plans and church plans. It does not include exempt employment-based IRAs like SEPS and SIMPLE IRAs. A covered plan does not include any health and welfare plan.

A "covered service provider" is a service provider that enters into a contract or arrangement with a covered plan, and reasonably expects to receive $1,000 or more in direct or indirect compensation from the plan. This dollar threshold does not include amounts paid by the employer and not reimbursed by the plan, but it includes amounts received from plan investments and other service providers.

A "covered service provider" performs plan services that fall into one of the following three service categories:

1. Fiduciary or registered investment advisor;
2. Recordkeeping or brokerage services provider; or
3. Other services for "indirect compensation."

"Fiduciary services" are services provided directly to the covered plan as an ERISA fiduciary. In general, an ERISA fiduciary is any person or entity that has discretionary authority with respect to management or administration of the plan. "Registered investment advisor services" are services provided directly to the covered plan as an investment advisor registered under either

the Investment Advisors Act of 1940 or state law. Plan record-keeping or brokerage services are covered services if provided to a covered plan that is an individual account plan that permits participants to direct the investment of their accounts, if one or more designated investment alternatives have been made available through a platform or similar mechanism in connection with the recordkeeping or brokerage services. "Other services for indirect compensation" include services within a broad list of categories that are reasonably expected to be paid for by indirect compensation (i.e., compensation paid by an unrelated party other than the plan or plan sponsor) or compensation paid among related parties, including accounting, auditing, actuarial, appraisal, banking, consulting, custodial, insurance, investment advisory, legal, recordkeeping, securities or other investment brokerage services, third party administration or valuation services.

A covered service provider must provide a written statement describing all services that it will provide to the plan. The service provider must also disclose whether it will provide any services to the plan as a fiduciary or registered investment advisor. All of the required disclosures need not be contained in the same document and may be provided in electronic format.

The covered service provider must disclose its compensation and how it will be received. It must disclose compensation received directly from the plan, indirect compensation, and compensation to be paid if the service contract terminates.

Record-keepers and brokers must, among other things, provide a description of all direct and indirect compensation to be received in connection with the recordkeeping services. In addition, a record-keeper must describe the manner in which compensation will be received, for example, whether the plan will be billed or compensation will be deducted from the plan. Generally, the disclosure of information regarding compensation or fees must be made reasonably in advance of entering into, renewing or extending the contract for service. During the term of the contract, any change to previously furnished information must be disclosed within 60 days of the service provider's becoming informed of the change unless disclosure is precluded due to extraordinary circumstances. Accordingly, at this juncture, plan fiduciaries must identify covered service providers, begin to take action to update contracts to provide for the required disclosures, ensure that they are receiving, reviewing and understanding the required information, and take any necessary action based on the information received. Such action includes an evaluation of the information received to determine if the charges enumerated in the disclosures are in fact reasonable.

The Participant Fee Disclosure Regulations

The participant fee disclosure regulations, effective August 30, 2012, generally require the plan administrator to disclose two major categories of fee information. The first is plan-related information, which includes general operational and identification information, administrative expenses and individual expenses. The second is investment-related information, which includes identifying information regarding the type of category of investment, performance data, benchmarks, and fee and expense information. The regulations apply to all participant-directed individual account plans, for example, 401(k) plans, subject to ERISA. The regulations do not apply to IRAs, simplified employee pensions, SIMPLE retirement accounts, defined benefit plans, health and welfare plans or plans with no participant-directed investments. Disclosure is required to any participant or beneficiary who can invest a plan account.

Disclosure is generally required on or before the date a participant or beneficiary can first direct investments and at least annually thereafter. Thus, if the plan allows an employee immediate entry on the date of hire, disclosure is required on the date of hire. If any information changes, the plan administrator must describe the change at least 30 days, but no more than 90 days in advance of any change (or as soon as reasonably possible).

The regulations require a plan administrator to disclose three types of plan-related information, including general information, administrative expenses and individual expenses. General information includes circumstances under which participants may give investment instructions,

along with any limitations, plan provisions related to exercise of voting, tender and similar rights, designated investment alternatives in the plan, the investment managers, and any brokerage windows, self-directed brokerage accounts or similar arrangements.

The required disclosure related to administrative expenses includes identifying any fees and expenses for general plan administrative services (e.g., legal, accounting and recordkeeping), if charged against a participant's account and not reflected in the total annual operating expenses of any designated investment alternative. A participant's quarterly statement must identify the dollar amount of fees and expenses actually charged during the quarter to the participants or beneficiaries account, the description of the services to which such charges relate and whether fees are paid from the operating expenses of one or more designated investment alternatives.

Individual expense disclosure includes identifying any fees and expenses that may be charged against the individual account of a participant or beneficiary on an individual, rather than a plan-wide basis. Examples include fees for processing plan loans, QDRO reviews, investment advice, commissions, front or back end loads or sales charges. Disclosure is not required if the charge is reflected in the total annual operating expenses of any designated investment alternative. The participant's quarterly statement must identify the dollar amount of fees and expenses actually charged during the quarter to the participant's account for such services and a description of the services to which the charges relate.

The investment-related information disclosure includes identifying information that names each designated investment alternative and the type of category of the investment, for example, money market fund, large cap stock fund, etc. Such information must include performance data including the average annual return for one, five and ten calendar year periods. There must be a statement that past returns do not indicate future performance and the disclosure must also name and identify returns of appropriate broad-based securities market index data. The disclosure must describe all fees related to the particular investment alternative. The disclosure must also describe the total annual operating expenses expressed as a dollar amount for a $1,000 investment, state that fees and expenses are only one of several factors to consider when making investment decisions, state that the cumulative effect of fees can substantially reduce the growth of a participant's account, and note that participants can visit the Department of Labor website for examples of the long-term effect of fees and expenses on a participant's account balance.

An Internet website must be made available for participants to access with respect to a designated investment alternative. The website must contain the name of the investment alternative issuer and, consistent with SEC rules, it must contain information on the alternative's objectives and goals, principal strategies, principal risks, portfolio turnover rate, performance data and fee and expense information. A glossary of terms must be made available and annuity information must be provided if available.

Performance status disclosures must be made in a chart or similar format to facilitate comparison. The disclosure must include the date, name, address and telephone number of the plan administrator, a statement regarding additional information available through the website address, how to request and obtain paper copies of information, and other appropriate information.

The regulations require that a plan administrator provide other disclosures upon a participant's request. Such information includes copies of prospectuses provided under SEC rules, copies of financial statements or reports (if such material is provided to the plan), a statement of value of a share or unit of each designated investment alternative and a list of assets comprising the portfolio of each investment alternative.

Acceptable forms of participant disclosure vary. Instructions for providing investment direction can be provided in the summary plan description and the regulation appendix provides a model that employers can use to provide the required comparative information. Other disclosures should be included in the quarterly benefit statement.

At this juncture, plan administrators should be reviewing disclosures provided by their record-keepers or third party administrators, or requesting such disclosures from those parties, and plan fiduciaries must continue to prudently select and monitor their investments.

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