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is presented by Spencer Fane Britt & Browne LLP  
in conjunction with United Benefit Advisors

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**Mastering the New Retirement  
Plan Fee Disclosure Rules**

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# Presenters



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# Program Highlights

- ▶ Background – DOL fee initiatives and fee litigation
- ▶ Service provider fee disclosure rules (disclosure to plan fiduciaries)
- ▶ Participant fee disclosure rules (disclosure by plan fiduciaries)
- ▶ Effective dates
- ▶ What plan sponsors should do now



# Focus on Fees

- ▶ Fees charged to/paid by DC plan participants can dramatically affect retirement income:



- An additional 50 basis points ( $\frac{1}{2}\%$ ) in fees can cost average participant \$100k or more over working career
- ▶ Decision to purchase services for a fee paid from plan is a “fiduciary” decision
    - Must be for benefit of plan participants

# Existing DOL Fee Initiatives

- ▶ Expanded reporting of fees paid to service providers (on Schedule C of Form 5500) – began with 2009 return
  - Report actual fees paid to each service provider who received \$5,000 or more in direct *or indirect* compensation from plan
  - Indirect compensation includes revenue sharing, gifts, prizes, meals, etc. not paid directly by the plan or the plan sponsor

# Fee Litigation

- ▶ 30+ cases pending, challenging DC plan fee practices, beginning in 2006
- ▶ Legal theory:
  - Excessive and undisclosed fees diminish returns and are “unreasonable”
  - Plans overpay when fiduciaries don’t understand fee structures
  - Service providers are conflicted by revenue sharing



# Service Provider Fee Disclosure

- ▶ DOL published “interim final” regulations under § 408(b)(2) of ERISA requiring disclosure of fees by service providers who contract with plan sponsors/fiduciaries to provide services to the plan where any portion of the fee will be paid from plan assets
- ▶ Regulations should be finalized “soon”

# 408(b)(2) Background

- ▶ Payments to “parties-in-interest” (from plan assets) are generally prohibited transactions (under § 406)
  - Constitutes “breach” of fiduciary duty
  - 15% excise tax
- ▶ “Parties-in-interest” include service providers
- ▶ ERISA § 408(b)(2) is exception to rule

# ERISA Section 408(b)(2)

- ▶ Statutory exemption from P/T rules for payments (from plan) to service providers, so long as:
  - Services are “necessary” for establishment or operation of plan
  - The contract/arrangement is “reasonable”
  - No more than “reasonable compensation” is paid to service provider

# “Reasonable” Contract

- ▶ Under existing regulations, a “reasonable” contract/arrangement:
  - Must permit termination by plan without penalty on reasonably short notice (to prevent plan from being “locked in” to an arrangement that has become “disadvantageous” to the plan)
  - Provisions to reasonably compensate provider for early termination are okay

# “Reasonable” Contract

- ▶ Under the soon-to-be-final regulations, a contract is not “reasonable” unless service provider discloses (in writing, in advance) the services it will provide and the direct and indirect compensation it will receive
- ▶ Failure to disclose = unreasonable contract = prohibited transaction

# 408(b)(2) Consequences

- ▶ If service provider fails to disclose fees (or if plan pays unreasonable fees):
  - Parties have committed a prohibited transaction under ERISA § 406
  - Plan fiduciary has breached its fiduciary duty – may be personally liable for loss
  - Service provider is subject to a 15% excise tax (100% if P/T not corrected)

# Covered Plans

- ▶ ERISA-covered qualified plans – both DB and DC plans
- ▶ ERISA-covered 403(b) plans
- ▶ Covered plans do not include:
  - Non-ERISA (govt. or church) plans
  - Section 457(b) plans
  - IRAs, SEPs, or SIMPLE plans
  - Health/welfare plans (at least for now)

# Covered Service Providers

- ▶ Any service provider that is also a “fiduciary” to the plan
- ▶ Registered investment advisors (RIAs)
- ▶ TPAs or brokers who provide a platform of investments to the plan
- ▶ Other parties receiving “indirect” compensation
- ▶ Investment providers/managers are generally not covered providers

# Covered Service Providers

- ▶ “Other” services for indirect compensation include:
  - Accounting, actuarial, appraisal, banking
  - Consulting, custodial, insurance, legal
  - Investment advisory, recordkeeping
  - Securities or investment brokerage
  - Third-party administration, valuation

# Covered Arrangements

- ▶ Contract/agreement to perform services for a covered plan
- ▶ Provider is expected to receive \$1,000 or more over the term of the contract
- ▶ Services may be performed by an affiliate or subcontractor (but compensation paid to subcontractor doesn't count towards the \$1,000 limit)

# Required Disclosures

- ▶ Description of services to be provided
- ▶ Description of all direct and indirect compensation service provider is expected to receive
- ▶ Description of how compensation will be received (deduct from plan?)
- ▶ Whether provider will be an ERISA fiduciary, and any conflicts of interest

# Definition of Services

- ▶ Recordkeeping/brokerage services:
  - Offering a platform of investment options to a defined contribution plan
  - Plan administration and transaction monitoring (enrollments, contributions, withdrawals)
  - Maintaining plan and participant records, accounts and statements

# Description of Services

- ▶ No specific level of detail required
- ▶ Fiduciary must decide if sufficient
- ▶ Special rule for recordkeeping services provided without explicit compensation
- ▶ Goal: Sufficient information to permit the employer/plan fiduciary to evaluate reasonableness of the compensation paid (for the services provided)

# Direct Compensation

- ▶ Direct Compensation is compensation received directly from the plan
  - Example: TPA charges each participant account \$50/year (or 5 bp per \$ in acct.)
- ▶ May be expressed as a dollar amount, percentage, formula, per-participant charge or any other reasonable method

# Indirect Compensation

- ▶ “Indirect Compensation” is compensation received from any source other than the plan, plan sponsor, another covered service provider, an affiliate or subcontractor
  - Example: TPA receives 20 bp “revenue sharing” from mutual fund company whose fund(s) are investment options under the plan

# Related Parties

- ▶ Related parties include affiliate that controls or is controlled by (or under common control with) provider, and subcontractors paid \$1,000 or more
- ▶ Report comp. paid to affiliate if it is:
  - Set on a transaction basis (*i.e.*, finder's fee or commission); or
  - Charged directly against plan and reflected in net value of investment

# Recordkeepers and Brokers

- ▶ Must provide fee information for each designated investment alternative (other than brokerage window) that is made available to plan, including:
  - Expense ratios
  - Transaction fees
  - Any other ongoing charge
- ▶ May use investment provider materials

# Special Broker/Recordkeeper Rule

- ▶ If providing recordkeeping services without explicit compensation:
  - Must provide reasonable, good-faith estimate of cost of services (and methodology used to prepare estimate)
  - Estimate must reflect what provider would charge a third party for the services, or prevailing market rate for services to similar plan

# Timing and Format

- ▶ Disclosures must be written, but do not have to be part of services contract
- ▶ No specific format (although final regs may require a “summary” disclosure)
- ▶ Must provide initial disclosure reasonably in advance of contract date
- ▶ Changes to required disclosures must be communicated within 60 days

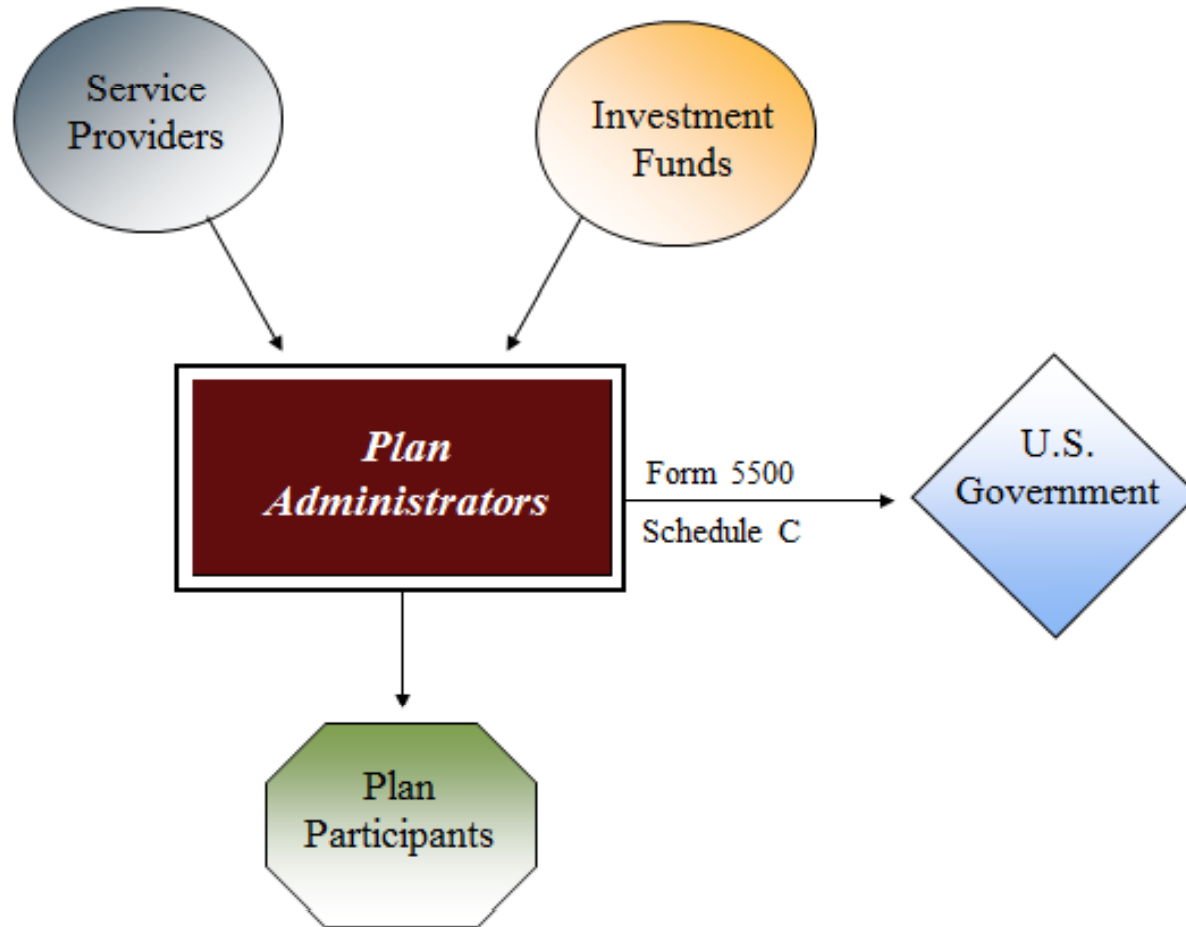
# “Innocent” Fiduciary Rule

- ▶ Class exemption covers fiduciary who:
  - Innocently enters into unreasonable arrangement (due to lack of disclosure)
  - Makes formal demand for fee disclosure
  - Notifies DOL if provider does not comply
  - Determines whether to continue or terminate the contract

# Effective Date – Service Provider Disclosure

- ▶ § 408(b)(2) rules apply to all contracts and arrangements between covered plans and covered service providers as of 4/1/2012, without regard to whether contract was entered into prior to that date
  - For contracts entered into before 4/1/2012, disclosures must be made no later than that date

# The Big Picture



# Participant Fee Disclosures

- ▶ General: Plan administrator must disclose plan- and investment-related information to participants
- ▶ Disclosures required
  - On participant's initial eligibility
  - Annual notice of general plan information
  - Quarterly notice of actual fees/expenses

# Covered Plans

- ▶ Applies to all participant-directed individual account plans (*e.g.*, 401(k), 403(b))
- ▶ Does **not** apply to IRAs, IRA annuities, SEPs, or SIMPLEs

# Key Issues for Employers

- ▶ “Plan administrator” is responsible for compliance
- ▶ Compliance **required** to obtain § 404(c) protection
- ▶ Disclosures **not optional**, but are **required** as part of fiduciary duty under ERISA
- ▶ Violations risk fiduciary liability and litigation, not just sanctions and penalties (*e.g.*, investment losses and excessive fees)

# In a Nutshell ...

## ▶ **Who**

- Plan administrator
- But service providers will take lead

## ▶ **What**

- Annual notice
  - Plan-related information
  - Investment-related information
- Quarterly notice

## ▶ **To Whom**

- Anyone with a plan account

# In a Nutshell ...

## ▶ **When**

### ○ Annual

- Initial – no earlier than 5/31/2012
- Thereafter, once in any 12-month period

### ○ Quarterly

- Initial – no earlier than 8/14/2012
- Thereafter, once in any 3-month period

## ▶ **How**

- Stand-alone notices or combined with others (e.g., SPD, quarterly statements)
- Electronically

# Who is Responsible?

- ▶ ERISA § 3(16) “plan administrator”
  - Often, plan administrator is the employer
  - Plans may contractually delegate this responsibility (e.g., to service provider)
- ▶ Relief for reasonable and good faith reliance on third parties
  - Plan administrator not liable for “completeness and accuracy” of disclosures made by third parties
  - But **no** relief from obligation to **provide** the notice

# The Notices

## ▶ Annual Notice

- Initial Annual Notice (5/31/2012)
- New employees
- Updates to Annual Notice

## ▶ Quarterly Notice

- Initial Quarterly Notice (8/14/2012)
- Subsequent Quarterly Notices

# Content of Annual Notice

- ▶ Plan-Related Information
  - General operational and identification
    - How to give investment instructions
    - Exercise of voting, tender, similar rights
    - Designated investment alternatives
    - Brokerage windows and self-directed accounts
    - Associated fees and expenses

# Content of Annual Notice

- ▶ Plan-Related Information
  - Administrative expenses
    - General explanation of fees for plan-level and individual administrative fees that may be charged (e.g., accounting, legal, QDROs, loans)
    - Additional quarterly disclosures of actual expenses charged to account in prior quarter

# Content of Annual Notice

- ▶ Investment-Related Information
  - Identifying information for investment funds (name, category, internet address for supplemental information)
  - Performance data (1-, 5-, and 10-year returns)
    - Special rules for fixed return funds (e.g., GICs) and employer stock
    - Special rules for target-date funds TBA

# Content of Annual Notice

- ▶ Investment-Related Information
  - Benchmark information
  - Fee and expense information
    - Amount and description
    - Description of limits on purchase, transfer, or withdrawal
    - Total annual operating expenses as a percentage and per \$1,000 invested
  - Website information for investment funds
  - Glossary of terms (sample at [www.ici.org](http://www.ici.org))

# Format of Annual Notice

- ▶ Investment-related information must be presented in chart (or similar) format that facilitates comparison
- ▶ Chart must include:
  - Date compiled
  - Name and address of plan administrator
  - How to obtain additional information
- ▶ DOL has published a model chart
  - [www.dol.gov/ebsa/participantfeerulemodelchart.doc](http://www.dol.gov/ebsa/participantfeerulemodelchart.doc)

# Model Chart – Returns

**Table 1—Variable Return Investments**

Name/ Type of Option	Average Annual Total Return as of 12/31/XX				Benchmark			
	1yr.	5yr.	10yr.	Since Inception	1yr.	5yr.	10yr.	Since Inception
<b>Equity Funds</b>								
A Index Fund/ S&P 500 www. website address	26.5%	.34%	-1.03%	9.25%	26.46%	.42%	-.95%	9.30% S&P 500
B Fund/ Large Cap www. website address	27.6%	.99%	N/A	2.26%	27.80%	1.02%	N/A	2.77% US Prime Market 750 Index
C Fund/ Int'l Stock www. website address	36.73%	5.26%	2.29%	9.37%	40.40%	5.40%	2.40%	12.09% MSCI EAFE
<b>Bond Funds</b>								
D Fund/ Bond Index www. website address	6.45%	4.43%	6.08%	7.08%	5.93%	4.97%	6.33%	7.01% Barclays Cap. Aggr. Bd.
<b>Other</b>								
E Fund/ GICs www. website address	.72%	3.36%	3.11%	5.56%	1.8%	3.1%	3.3%	5.75% 3-month US T-Bill Index
F Fund/ Stable Value www. website address	4.36%	4.64%	5.07%	3.75%	1.8%	3.1%	3.3%	4.99% 3-month US T-Bill Index

# Model Chart – Fees

**Table 3—Fees and Expenses**

Name / Type of Option	Total Annual Operating Expenses		Shareholder-Type Fees
	As a %	Per \$1000	
<b>Equity Funds</b>			
A Index Fund/ S&P 500	0.18%	\$1.80	\$20 annual service charge subtracted from investments held in this option if valued at less than \$10,000.
B Fund/ Large Cap	2.45%	\$24.50	2.25% deferred sales charge subtracted from amounts withdrawn within 12 months of purchase.
C Fund/ International Stock	0.79%	\$7.90	5.75% sales charge subtracted from amounts invested.
<b>Bond Funds</b>			
E Fund/ Bond Index	0.50%	\$5.00	N/A
<b>Other</b>			
F Fund/ GICs	0.46%	\$4.60	10% charge subtracted from amounts withdrawn within 18 months of initial investment.
G Fund/ Stable Value	0.65%	\$6.50	Amounts withdrawn may not be transferred to a competing option for 90 days after withdrawal.
Generations 2020/ Lifecycle Fund	1.50%	\$15.00	Excessive trading restricts additional purchases (other than contributions and loan repayments) for 85 days.
<b>Fixed Return Investments</b>			
H 200X / GIC	N/A		12% charge subtracted from amounts withdrawn before maturity.
I LIBOR Plus/ Fixed- Type Invest Account	N/A		5% contingent deferred sales charge subtracted from amounts withdrawn; charge reduced by 1% on 12-month anniversary of each investment.

# Content of Quarterly Notice

- ▶ Amount actually charged to participant accounts during prior quarter
  - Plan-level charges
    - Description of services to which charges relate
    - No requirement to unbundle and report amounts included in investment fund operating expenses
    - But, if applicable, explanation that some plan administrative expenses were paid from annual operating expenses of one or more investment funds (*i.e.*, revenue sharing)
  - Individual charges (e.g., for loans, QDROs, distributions, investment advice services)

# To Whom?

- ▶ Annual and Quarterly Notice
  - Any individual who has right to direct investments under plan
    - Participants currently contributing
    - Participants eligible but not contributing (if have an account)
    - Term-vested with accounts
    - Beneficiaries
    - Alternate payees under QDROs

# When?

## ▶ Annual Notice

- Initial Annual Notice – later of:
  - 5/31/2012, or
  - 60 days after 1<sup>st</sup> day of 1<sup>st</sup> plan year beginning on/after 11/1/2011
- Subsequent Annual Notices – at least once in any 12-month period
- New employees – on or before first day eligible to direct investments in plan
- Updates – 60-90 days before effective date of change

# When?

- ▶ Quarterly Notice
  - Initial Quarterly Notice
    - 45 days after end of calendar quarter in which Initial Annual Notice required
    - For calendar year plans, 8/14/2012
  - Subsequent Quarterly Notices – at least once in any 3-month period

# How?

- ▶ Service providers will take the laboring oar
- ▶ DOL reserved rules on method of distribution
- ▶ Generally:
  - Stand-alone paper forms
  - Quarterly statements
  - SPD (if meet the frequency requirements)
  - Electronic

# Electronic Delivery

- ▶ Confusing interim guidance from DOL
- ▶ Both plan- and investment-related (e.g., comparative chart) info may be provided electronically
- ▶ Electronic delivery must satisfy either:
  - Current DOL safe harbor rules, or
  - Conditions in DOL Technical Release 2011-03R

# Effective Date(s) – Summary



- ▶ For calendar year plans:
  - Service provider disclosures must be made by 4/1/2012
  - Initial participant fee disclosure must be made by 5/31/2012 (60 days later)
  - First quarterly participant fee disclosure must be made by 8/14/2012 (45 days after end of 2<sup>nd</sup> quarter)

# Traps for the Unwary



- ▶ Some plan amendments may require update of Annual Notice **before** SMM
- ▶ Changing investment options, default funds, and new restrictions imposed by funds requires updated Annual Notice **in advance** of change
- ▶ Exclusion of eligible employees from participation an automatic fiduciary breach?

# Traps for the Unwary



- ▶ Loss of ERISA § 404(c) protection if fail to provide participant fee notices
  - Liability for investment losses?
- ▶ Unique assets not tracked by record keeper will not be included in Notices prepared by that record keeper

# Action Steps

- ▶ Ask service providers about their role – who will distribute the notices (Annual and Quarterly)
- ▶ Insist on contractual delegation of responsibility to service provider
- ▶ Review and understand the fee chart
- ▶ Prepare for questions from participants
  - Decide who will answer questions (e.g., employer, service provider)
  - Consider creating a Q&A template to keep answers consistent



# Action Steps

- ▶ If service provider prepares Annual Notice, review plan-related disclosures for accuracy
- ▶ Benchmark fees in advance
- ▶ Evaluate how fees are allocated
  - Asset-based? Break point?
  - Pro rata? Per capita?
- ▶ Communicate **value** of plan before disclosures are made

# Action Steps

- ▶ Explain fees in context of plan value
  - Matching contributions
  - Internet access
  - Plan loans
- ▶ Understand “wrap” fees
  - Asset-based charges separate from operating expenses that are deducted from participants’ accounts
  - Generally will be disclosed as dollar amount on Quarterly Notice



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