



## **Managing Retirement Plan Expenses in the Fee Disclosure Era**

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# Agenda

- Requirements of Fee Disclosure
  - Vendor-to-Plan Sponsor
  - Plan Sponsor-to-Participant
- Practical Considerations
  - Fee Policy Statements
  - Fee Parity and Reasonableness
  - Fee Trends
- Next Steps
- Questions / Answers

# Vendor-to-Plan Sponsor Fee Disclosure

Vendor-to-plan sponsor fee disclosure under ERISA section 408(b)(2):

- Objective: enable plan fiduciaries to better evaluate the reasonableness of plan expenses as required by ERISA section 408(b)(2).
- Noncompliance = prohibited transaction and subjection to penalty under the Internal Revenue Code.
- Requires “covered service provider” to disclose certain fee information to plan sponsors.
  - Covered service providers include registered investment advisers, investment providers, recordkeepers, brokers, TPAs, consultants, attorneys and accountants.

# Vendor-to-Plan Sponsor Fee Disclosure

Specific requirements:

- Covered service providers that expect to receive \$1,000 in compensation during the term of the service arrangement must disclose these fees to plan sponsors.
  - Includes direct and indirect compensation.
  - Direct compensation is compensation received directly from the plan.
  - Indirect compensation generally is compensation received from any source other than the plan sponsor, the covered service provider, an affiliate, or subcontractor.
- The disclosure must:
  - Describe the services being rendered;
  - Declare fiduciary status, as applicable;
  - Report all direct and indirect compensation, including revenue sharing, 12b-1 fees and shareholder sub-TA fees;
  - Report compensation received in the event of a contract termination, including investment loads;
  - Explain the manner in which compensation is received.
- The plan fiduciary must ensure that all covered service providers have properly disclosed their fees.
  - Written follow-up requirements apply.
  - Must notify DOL if fees are not adequately disclosed.

# Plan Sponsor-to-Participant Fee Disclosure

Plan sponsor-to-participant fee disclosure under ERISA section 404(a):

- Objective: ensure that participants have the details necessary to make well informed plan and investment elections.
- Noncompliance = prohibited transaction and subjection to penalty under the Internal Revenue Code.
- Requires plan sponsors to disclose certain plan and investment information to participants.
  - Plan sponsors must first receive vendor-to-plan sponsor disclosure information in order to in turn disclose it to participants.
  - Recordkeeping vendors are likely to provide some level of support to plan sponsors in meeting this obligation.

# Plan Sponsor-to-Participant Fee Disclosure

Specific requirements:

- Annually, plan sponsors are required to disclose certain plan and fee information to eligible employees and participants, including:
  - A statement as to whether participants may direct their own investments;
  - An explanation of limitations on the participant's ability to direct investments and to make withdrawals;
  - A list of all designated investment alternatives, including the type/category of the investment, 1, 5, and 10 year average performance relative to benchmarks, operating expenses, fixed returns, investment term and minimum guaranteed rate (as applicable);
  - A description of any available participant-directed brokerage windows;
  - A list of all fees and expenses related to the plan's administration and the basis of the allocation of those fees to participant accounts;

# Plan Sponsor-to-Participant Fee Disclosure

Specific requirements (continued):

- Annually, plan sponsors are required to disclose certain plan and fee information to eligible employees and participants, including:
  - A list of participant paid fees and expenses such as transaction processing fees and investment loads;
  - Information regarding the effect of fees on investment returns; and,
  - A website address that can be used to obtain additional investment information.
  - Additional information must be furnished upon request, including prospectuses, designated investment alternative financial statements, valuation statements and investment portfolio asset information.
- Participants must also receive a quarterly benefit statement describing any amount actually charged to the participant during the quarter, and a description of the services to which those charges relate.

# Effective Dates

The plan sponsor and participant fee disclosure regulations under ERISA sections 408(b)(2) and 404(a) are now in final status.

Effective dates:

- Disclosure by covered service providers to plan sponsors under ERISA 408(b)(2) is effective July 1, 2012.
- Disclosure by plan sponsors to participants under ERISA 404(a) is effective for plan years beginning on or after November 1, 2011.
  - However, because plan sponsors need the vendor-to-plan sponsor disclosures in order to disclose information to participants, the DOL extended the application of the plan sponsor-to-participant disclosure to coordinate with the effective date of the vendor-to-plan sponsor disclosure requirements under 408(b)(2).
  - Initial annual plan sponsor-to-participant disclosures must be provided to eligible employees and participants within 60 days of the plan's "applicability date," or within 60 days of the effective date of the vendor-to-plan sponsor regulations, whichever comes later.
  - The first quarterly disclosures must be provided 45 days after the quarter in which initial annual plan sponsor-to-participant fee disclosures have been made.



# Plan Sponsor-to-Participant Effective Date Examples

Employer A sponsors an ERISA-covered 403(b) plan with the plan year ending on December 31.

- Employer A must provide the initial annual fee disclosure notice to eligible employees and participants no later than August 30, 2012 (i.e. 60 days after the July 1, 2012 effective date of the vendor-to-plan sponsor fee disclosure regulations).
- Employer A must provide the first quarterly participant fee disclosure by November 14, 2012 (i.e. 45 days after the quarter, ending September 30, 2012, during which the initial annual disclosure was provided).

# Plan Sponsor-to-Participant Effective Date Examples

Employer B sponsors an ERISA-covered 401(k) plan with a plan year ending on June 30.

- Employer B must provide the initial annual fee disclosure notice to participants no later than August 30, 2012 (i.e. 60 days after the July 1, 2012 effective date of the vendor-to-plan sponsor fee disclosure regulations).
- Employer B must provide the first quarterly participant fee disclosure by November 14, 2012 (i.e. 45 days after the quarter, ending September 30, 2012, during which the initial annual disclosure was provided).

# Plan Sponsor-to-Participant Effective Date Examples

Employer C sponsors an ERISA-covered 401(a) plan with the plan year ending September 30.

- Employer C must provide the initial annual fee disclosure notice to participants no later than November 29, 2012 (i.e. 60 days after the “plan applicability date” of October 1, 2012, which is the first day of the plan year beginning on or after November 1, 2011).
- Employer C must provide the first quarterly participant disclosure by February 14, 2013 (i.e. 45 days after the quarter, ending December 31, 2012, during which the initial annual notice was provided).

# Vendor-to-Plan Sponsor Fee Disclosure: Practical Considerations

- Applies to ERISA governed plans only.
  - NonERISA plans do not have to comply, but may as a matter of best practice.
- The format of the vendor-to-plan sponsor disclosure will likely vary from covered service provider to covered service provider.
- The DOL intends to require covered service providers to furnish a guide or similar tool to assist plan fiduciaries in identifying, locating and understanding the potentially complex information that must be disclosed.
  - The DOL will allow a comment period once the proposed model guide is published.
  - The proposed model guide is expected in the “near future.”
- Covered service providers must report fee changes only once per year.
- Covered service providers not in compliance by July 1, 2012 will be in violation of ERISA’s prohibited transaction rules and be subject to penalty under the Internal Revenue Code.
  - Plan sponsor follow up is required.
  - Report noncomplying covered service providers on Schedule C.

# Vendor-to-Plan Sponsor Fee Disclosure: Practical Considerations

- Remember that both annual and quarterly disclosures (to all participants) are required.
  - Annual disclosures must go to all eligible employees.
  - Quarterly disclosures must go to all participants, and will often be integrated with a participant's typical quarterly statement.
- Expect/demand your recordkeeping vendor's support.
  - Recordkeeping vendors will provide a varied level of support, so get clear as soon as possible about the level of support you can expect.
  - Some vendors have participant fee disclosure samples available.
- Electronic delivery is permitted...
  - To workplace email address so long as the employee is required to use a computer in their daily work.
  - To personal email address so long as the employee consents in advance to electronic delivery.

# Vendor-to-Plan Sponsor Fee Disclosure: Practical Considerations

- The fee disclosure regulations require disclosure of fees related to all investment products and services offered through the plan; this includes deselected vendor products and legacy accounts.
  - Creates unique challenges for 403(b) plan sponsors that operate or have at one point operated in a multiple vendor environment.
  - Additional guidance may be forthcoming in this regard.
- If the plan has multiple vendors (including legacy vendors), the disclosures to participants must be consolidated or at least sent in the same envelope.
- Practically speaking, participant disclosures must be sent no later than August 30, 2012 (for calendar year-end plans).
- May create impetus for plan sponsors to consolidate recordkeeping vendors and/or renegotiate fees.
- Failure to comply renders the entire plan arrangement a prohibited transaction.

# Results of Participant Fee Disclosure

- A noticeable trend toward increased participant scrutiny on fees has emerged.<sup>1</sup>
  - Under ERISA, participants must receive the information necessary to make informed decisions with regard to their participation in the plan.
- Differences in disclosure formats may complicate cross-plan and multiple vendor environments.
- Comparative information may be difficult to locate depending on format.
- Prepare for participant inquiries regarding fee methodology/allocation.
  - What does the sponsor pay for?
  - What does the participant pay for?
  - How do the choices I make impact the fees I pay?
  - Are these issues “fair”?

<sup>1</sup> Bureau of National Affairs reports more than 30 cases brought against plan fiduciaries by participants alleging fiduciaries imprudently allowed plan service providers to receive excessive investment management and administrative fees.

# Fee Policy Statement

- Sets forth manner in which expenses related to the plan will be allocated and paid
- Establishes code of conduct prescribed by ERISA
- Documents sponsor's intent with regard to providing benefits under the plan
- Paying expenses related to plan maintenance and management
- Documents the fiduciary decisions with regard to how expenses paid by the plan will be allocated
- Defines process by which fee reasonableness will be assessed

## Elements of a Strong Fee Policy Statement

1. Purpose of the Fee Policy Statement
2. Fees allocated to the Plan Sponsor
3. Fees allocated to Plan Assets
4. Fees allocated to Plan Participants
5. Method for capturing "excess" revenue
6. Method for disclosing fees to plan participants
7. Method and frequency for benchmarking fees



# Defining Fair / Reasonable Fees

- How are the plan's fees and fee allocation determined?
  - Vendor-driven
  - Circumstance-driven
  - Participant-driven
- What does the sponsor pay for?
- What does the plan/participant pay for?
- How are plan expenses allocated?
- How does a plan sponsor know that vendor fees are reasonable?

# Retirement Plan Fee Trends

- Fee compression
  - Vendor consolidation
  - Reduced search activity
  - Heavier utilization of online service protocols
  - Plan level cost/profitability transparency
  - Revenue-life pricing models
- Movement away from exclusive reliance on asset-based pricing
- Reduction in bundling
  - Investment management
  - Employee communication
  - Compliance/legal

# Retirement Plan Fee Trends (cont.)

- Greater control of participant fees
  - Reduced utilization of revenue sharing
  - Fee-leveling
- Increased fee-at-risk clauses
- Increased acceptance/use of “excess” revenue capture programs
  - Plan Expense Reimbursement Agreements
  - ERISA Budget Accounts

# Next Steps

1. Request Vendor-to-Plan Sponsor fee disclosure notices from covered service providers.
2. Determine how your retirement plan recordkeeper will support you on Plan Sponsor-to-Participant fee disclosure.
3. Report plan-paid fees on Schedule C.
4. Send Plan Sponsor-to-Participant fee disclosure notices in a timely manner.
5. Aggregate fees to determine total cost of plan operation.
6. Evaluate the value and reasonableness of expenses paid by the plan's assets.
7. Determine the best method for allocating plan expenses (i.e. sponsor-paid versus plan-paid).
8. Draft and execute a Fee Policy Statement.
9. Negotiate with or find vendors who can execute on the plan's fee strategy.
10. Benchmark and assess plan fees on a regular basis.

# Questions / Answers

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