

401(k) FEE DISCLOSURE GUIDELINES **New Regulations under ERISA §408(b)(2) and §404(a)(5)**

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*This article has been updated from the original version we posted in September 2010. For one thing, the effective date has been moved to the second quarter of 2012. Plan-level fees will have to be disclosed to the Employer by **April 1, 2012**. Participant-level fees will first appear on participant statements on **June 30, 2012**. The Annual Disclosure requirements will have to be delivered to participants by **April 1, 2012**.*

401(k) fee disclosures come in two types, both of which are discussed in detail in this article:

- Plan-level disclosure – from providers to employers (as outlined in ERISA §408(b)(2)); and
- Participant-level disclosure – from providers to participants (as outlined in ERISA §404(a)(5))

PARTICIPANT-LEVEL FEE DISCLOSURE

Participant fee disclosures are REQUIRED for:

- Participant-directed defined contribution plans subject to ERISA (401(k) and 403(b) plans)
- All participants regardless of the size of the plan

Who must get the notices?

- Newly eligible participants (Annual disclosures)
- Eligible but not participating (Annual disclosures)
- Active participants and beneficiaries (Annual *and* Quarterly disclosures)

Which annual disclosures must be provided?

1. Plan information – investment alternatives, managers, Self-Directed Brokerage Accounts, investment instructions, etc.
2. Administration expenses – recordkeeping, TPA, legal, accounting, etc.
3. Individual expenses – fees that will be charged for participant-driven fees (loans, distributions, QDROs, etc.)
4. Investment benchmark – compare performance of each fund to a broad-based market index
5. Performance – 1-, 5-, and 10-year returns for each investment option available in the plan. *This may be difficult for portfolios that consist of a group of separate funds like asset allocation models.*
6. Fees/expenses – asset charge as a percentage and dollar amount for each \$1,000 invested
7. Web address – for each fund in the plan. *Offering a general web address is probably not acceptable since it is advised that information can be found in one or two clicks. Again, this may be difficult for asset allocation models.*
8. Glossary of terms – investment terms need to be listed so participants can easily understand.

Which quarterly disclosures must be provided?

- Statement of actual charges or deductions – fees that were actually charged to the participant account during that period (quarter). *This will likely be a line-item on the participant statement separate from the investment gain/loss.*

When must disclosures be issued?

- **Initially** – Information must be provided to newly-eligible participants 30 days prior to their initial eligibility (or upon eligibility if less than 30-day wait required). This will likely be in the form of an Enrollment Kit and the Fund Summary Chart.
- **Quarterly** – to active participants. First will be required no later than 8/14/2012, then within 45 days after the end of each quarter. This will likely be in the form of a Participant Statement.
- **Annually** – to all eligible participants. No later than 4/1/2012, then by first day of the plan year thereafter. This will likely be an Enhanced Statement similar to what is found in the Enrollment Kit, with an updated Fund Summary Chart.
- Ongoing information (changes) must be provided no less than 30 and no more than 90 days before the change
- Target Date funds will likely be required to disclose additional information other than just fees. This may include any or all of the following details:
 - an explanation of each fund's asset allocation
 - how the asset allocation will change over time
 - the point in time at which the investment will reach its most conservative asset allocation
 - any assumptions or explanations about the implication of the investors who may select each fund

How does an employer comply with the Fee Disclosure rules?

- **The Plan Sponsor (employer) is responsible for making the 401(k) fee disclosures!**
- Electronic disclosures are likely to be allowed
- Every employer must work closely with their provider to ensure they will be able to make sure these disclosures are made in a timely fashion
- Beware of challenges that may face your providers in helping an employer meet these responsibilities:
 - Providers don't have addresses for eligible non-participants
 - If you have more than one provider (like many 403(b) plans have), the employer will have to deliver information from all providers in the same format at the same time

SUMMARY

The Department of Labor (DOL) has taken a firm stand on making sure participants are provided with information about the investments they may choose for their retirement plan account. This information may end up creating more questions than answers, at least at first. We strongly recommend all plan trustees, committee members, human resources (HR) staff, and payroll clerks be provided with advance notice about the new requirements and what the information for their plan participants will look like.

Now is the time to review the information for your plan; don't wait until March 2012!!



Beth Harrington is the President of Benefit Resources, Inc., a retirement plan administration company located in Sacramento California. This document is for informational purposes only and should not be construed as legal and/or tax advice.

PLAN-LEVEL FEE DISCLOSURES

*Plan providers will be required to disclose information to Plan Sponsors (employers) at a different level than the participant-level fee disclosure requirement. This portion of our article explains what employers can expect under these new rules, which are effective **April 1, 2012**.*

First, some terminology:

- **Covered Plan:** A Defined Contribution (401(k), Profit Sharing, etc.) or Defined Benefit plan (including Cash Balance plan) covered by ERISA. Plans that are *exempt* from ERISA (IRA, owner-only plans, certain 403(b) plans not covered by ERISA, SEP, welfare benefit plans) are not considered Covered Plans.
- **Fiduciary:** A person who exercises discretionary control or authority over the management of a retirement plan.
- **Registered Investment Advisor (RIA):** An investment professional registered with the Securities and Exchange Commission who manages the investments of the plan or makes recommendations about plan investments. An RIA may sign on as a Fiduciary of a retirement plan under ERISA §3(21), the Investment Advisors Act of 1940, or State law.
- **Direct compensation:** Plan expenses paid directly from plan assets for services provided.
- **Indirect compensation:** Payments from a source other than the plan, plan sponsor, or Covered Service Provider. Often these are paid by companies managing the investments of the plan. For example, indirect compensation may include commissions, 12b-1 fees, finder's fees, etc.
- **Recordkeeper:** Company that monitors transactions, maintains participant accounts and records, and prepares statements. May also serve as Third Party Administrator (TPA).
- **Covered Service Provider:** Any of the following three categories that is expected to earn over \$1,000 in direct or indirect compensation from the plan:
 - ✓ RIA, hedge fund manager, private equity partnership manager, managing partner of a limited partnership (if 25% or more of the partnership is held by benefit plans)
 - ✓ Recordkeeper or brokerage service provider who provides services to a participant-directed plan and who is directly involved or compensated by one or more of the investment options in a Covered Plan (individual brokerage accounts are exempted)
 - ✓ Accountant, actuary, appraiser, attorney, banker, broker-dealer, consultant, custodian, insurance agent, TPA or other entity that receives Indirect Compensation from investments held by the plan. (Affiliates or subcontractors are exempt from these new regulations, but see "Form of Compensation" below)



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Disclosure requirements

- **Fee disclosures** – Each Covered Service Provider must provide written disclosure of the following information for each investment option available in the plan:
 - ✓ Sales charges
 - ✓ Loads
 - ✓ Redemption, surrender and/or exchange fees
 - ✓ Expense ratios for annual operating expenses
 - ✓ Any other ongoing expenses
 - ✓ Details about services to be provided
 - ✓ Compensation paid (dollar amount, percentage, formula or per-participant amount)

- **Form of compensation** – The Covered Service Provider must disclose which of the following types of compensation is received:
 - ✓ Direct compensation
 - ✓ Indirect compensation
 - ✓ Fees paid to an affiliate or sub-contractor, including any transaction fees
 - ✓ Termination fees to be charged to discontinue the arrangement, if any

- **Recordkeeping fees** are to be reported separately

- **Timing of disclosures:**
 - ✓ Initially, the Fiduciary must have sufficient time to review the fees before the arrangement is finalized
 - ✓ Not later than 60 days prior to any change in fees
 - ✓ Covered Service Provider must respond to a request about fees from a Fiduciary within 30 days
 - ✓ As of **July 16, 2011**, all existing and future arrangements must comply with these regulations

Failure to comply with the regulation

- Fees paid by plan assets will be considered a *prohibited transaction* under ERISA
- All compensation paid to the Covered Service Provider would have to be refunded to the plan (plus interest) to correct the prohibited transaction
- There is a 20% excise tax penalty under ERISA on the amount of the fees involved as a result of the prohibited transaction. The excise tax is not a deductible expense and cannot be paid from plan assets. The IRS may also charge a 15%-100% tax
- Fiduciaries may be exposed to litigation from participants claiming the fees charged to the plan were unreasonable
- The burden of proof that no prohibited transaction has occurred lies with the Covered Service Provider, not with the DOL

Compliance relief

- Errors in the disclosure must be corrected within 30 days after discovery



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- There is a class exemption for the plan Fiduciary if a disclosure failure is discovered after entering into an arrangement
- If a Fiduciary did not know a Covered Service Provider would fail to make the required disclosure, the Fiduciary may be allowed relief if they notify the DOL of the Covered Service Provider's failure to disclose the necessary information

SUMMARY

These new regulations will shine a light on recordkeeping and investment fees being charged to plans and plan participants. They will allow Fiduciaries to more accurately compare the relative costs of different service providers including those offering “bundled” arrangements and potential conflicts of interest.



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