

# ***Fee Disclosures and Fiduciary Responsibilities***

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# Agenda

- Overview of Department of Labor Initiatives
- Final Regulation Relating to Service Provider Fee Disclosures under ERISA Section 408(b)(2)
- Final Regulation on Participant Level Fee Disclosures under ERISA Section 404(a)
- Fiduciary Responsibilities

# Department of Labor (DOL) Initiatives

- Updated Form 5500 Schedule C (effective with 2009 filing)
- Fee Disclosures by Service Providers to Plan Fiduciaries (effective ~~April 1, 2012~~ **July 1, 2012**)
- Fee Disclosures by the Plan Fiduciaries to Plan Participants (effective for the first plan year, beginning on, or after, Nov. 1, 2011 – ~~January 1, 2012~~ for calendar year plans **August 30, 2012 (initial) and November 14, 2012 (1<sup>st</sup> quarterly statement)**)

# *Service Provider Fee Disclosures under ERISA 408(b)(2)*

- On February 2, 2012, the DOL finally issued the final regulations covering the disclosures that certain service providers must provide to plan fiduciaries (published in the Federal Register on February 3, 2012 (29 CFR Part 2550.408b-2)).
- The required disclosures are intended to assist plan fiduciaries in satisfying their fiduciary obligations under ERISA.
- Failure to comply with the requirements per the final rules may result in a prohibited transaction and an excise tax.

# *Service Provider Fee Disclosures under ERISA 408(b)(2) (cont'd)*

- Covered Plan
- Covered Service Provider
- Initial Disclosure Requirements
- Timing of Disclosure
- Reporting and Disclosure Information
- Disclosure Errors
- Exemption for Responsible Plan Fiduciary (RPF)

# Covered Plan

- An employee pension benefit plan or a pension plan within the meaning of ERISA Section 3(2)(A)
- Does not include – SEP, SIMPLE, IRA's
- Final rule updated to exclude all or that part of a 403(b) plan that consists exclusively of “frozen” contracts or accounts prior to January 1, 2009

# *Covered Service Provider*

Covered Service Provider (CSP) is one that:

- enters into a contract or arrangement with a covered plan; and
- reasonably expects to receive \$1,000 or more in compensation, (direct or indirect) to be received;
- in connection with providing one or more of the services described in the final rule.

# *Covered Service Provider*

- 3 Categories
- Category A – Fiduciary Services
- Category B – Recordkeeping and Brokerage services
- Category C – Services for Indirect Compensation



# CSP – Category A

## Fiduciary Services:

- those providing services as an ERISA fiduciary or as an investment advisor registered under either the Investment Advisers Act of 1940 (Advisers Act) or any State law.
- 3 subsections as in the interim final rule
  - 1) includes ERISA fiduciary services provided **directly** to the covered plan – (A)(1) fiduciary
  - 2) includes ERISA fiduciary services provided to an investment contract, product, or entity that **holds plan assets** and in which the covered plan has a direct equity investment - (A)(2) fiduciary
  - 3) includes services provided directly to the covered plan as an investment adviser **registered** under either the Advisers Act of State Law – (A)(3) RIA

# CSP Category B

## Recordkeeping or Brokerage Services:

- includes providers of recordkeeping services or brokerage services to a covered plan that
  - is an ERISA section 3(34) individual account plan
  - that permits participants and beneficiaries to direct the investment of their accounts,
  - if the plan has one or more designated investment alternatives will be made available (e.g., through a platform or similar mechanism) in connection with such recordkeeping services or brokerage services.

# CSP Category C

## Services for Indirect Compensation:

- includes those providing specified services to the covered plan when the CSP reasonably expects to receive “indirect” compensation or certain payments from related parties
- Services include accounting, auditing, actuarial, appraisal, banking, consulting (*i.e.*, consulting related to the development or implementation of investment policies or objectives, or the selection or monitoring of service providers or plan investments), custodial, insurance, investment advisory (for plan or participants), legal, recordkeeping, securities or other investment brokerage, third party administration, or valuation services provided to the covered plan.

# *CSP – Multiple Service Providers*

- May agree among themselves
- The other service providers may be affiliates of or subcontractors to the CSP
- CSPs' disclosures would reflect their status in accordance with the final rule

# *Determine that you are a CSP*

- Make initial disclosures
  - Services
  - Status
  - Compensation
- Disclose changes in information ASAP
- Furnish other information relating to compensation as requested

# *Initial Disclosure Requirements*

- Description of Services
- Status of CSP, Affiliates, and Subcontractors
- Disclosure of Compensation
- Disclosure Regarding Recordkeeping Services
- Investment Disclosure – Fiduciary Services
- Investment Disclosure – Recordkeeping and Brokerage Services
- Manner of Receipt of Compensation
- Summary or Guide to Initial Disclosures

# *Initial Disclosure Requirements (cont'd)*

## Description of Services

- The final rule requires that the CSP describe the services to be provided to the covered plan pursuant to the contract or arrangement.

# *Initial Disclosure Requirements (cont'd)*

## Status of Covered Service Providers, Affiliates, and Subcontractors

- CSP must state that the CSP, an affiliate, or subcontractor will or expects to provide services under Category A
  - 1 = Fiduciary to Plan
  - 2 = Fiduciary to investment product holding plan assets
  - 3 = Registered Investment Advisor (RIA)
  
- Not Category A = no need to disclose that “not a fiduciary”



# *Initial Disclosure Requirements (cont'd)*

## Disclosure of Compensation

- Direct (either total or by service)
- Indirect
  - Describe compensation, identify services provided & identify payer
- Compensation paid among related parties
  - Describe compensation, identify services provided, identify payer and recipient and status as an affiliate or subcontractor
- Compensation for termination of contract or arrangement
  - Describe any compensation reasonably expected to receive including how prepaid amounts will be calculated and refunded upon termination

# *Initial Disclosure Requirements (cont'd)*

## Disclosure Regarding Recordkeeping Services

- Description of all direct & indirect compensation
- Reasonable and good faith estimate including an explanation of methodology and assumptions used
- Detailed explanation of the recordkeeping services that will be provided

# *Initial Disclosure Requirements*

## Investment Disclosure – Fiduciary Services

- Two additional disclosures for designated investment alternatives (DIAs) are required at the plan level
  - The total annual operating expenses of the DIA must be calculated in a manner consistent with the participant-level disclosures of ERISA 404(a) and expressed as a percentage.
  - Disclosure of any other information relating to DIAs that is within the control of, or reasonably available to the CSP is required, if the information is considered investment-related and of a nature which must be provided under the participant-level disclosures.
- This change underscores the importance of considering the plan-level and participant-level disclosures together as these rules are clearly interrelated.

# *Initial Disclosure Requirements*

## Investment Disclosure – Recordkeeping and Brokerage Services

- A covered service provider may now comply with disclosure requirements for investment-related information by distributing current disclosure materials provided by the DIA issuer(s), or by the replication of such materials.
- The final rule focuses on the fact that the institution issuing the materials must be regulated rather than whether the disclosure materials are regulated.
- The covered service provider disseminating pass-through information must act in good faith; must not know that the materials are incomplete or inaccurate; and must state that it makes no representations as to the completeness or accuracy of such materials.

# *Initial Disclosure Requirements (cont'd)*

## Manner of Receipt of Compensation

The final rule requires a description of the manner in which the compensation will be received, such as whether

- the covered plan will be billed; or
- the compensation will be deducted directly from the covered plan's account(s) or investments.

# *Initial Disclosure Requirements (cont'd)*

## Summary or Guide to Initial Disclosures – Format and Delivery

- No particular manner or format
- In writing – paper and/or electronic
- Multiple documents from multiple sources
- Does not need to be part of service contract
- Future “guide”

# *Timing of Disclosure*

- Initial Disclosures – July 1, 2012
- Changes to Initial Disclosures
  - Generally, CSPs must disclose changes to initial information as soon as practicable, but no later than 60 days from when the CSP is informed of such change.
  - Disclosures of changes to investment-related information are to be made at least annually.

# *Reporting and Disclosure Information*

Service providers must disclose compensation or other information related to their service arrangements upon the request of the RPF or plan administrator, reasonably in advance of the date upon which such person states that they must comply with ERISA's reporting and disclosure requirements.



# *Disclosure Errors*

- The final rule allows for timely corrections of an error or omission in required disclosures when a CSP is acting in good faith and with reasonable diligence.
- Such corrections must be made not later than 30 days from the date that the CSP knows of the error or omission.
- The final rule clarifies that this covers errors/omissions in the disclosure of changes.

# *Exemption for Responsible Plan Fiduciary*

- The regulation provides an exemption for plan fiduciaries if the service provider fails to provide required disclosures so long as various requirements are met.
- The exemption originally stated that if the service provider failed to provide the information upon request, the plan fiduciary was required to consider whether to continue the relationship with the service provider.
- The final rule now requires the plan fiduciary to terminate the relationship if the service provider fails to provide requested information relating to future services.

# *Application of IRC Section 4975*

- Requires compliance with Service Provider fee disclosures to avoid excise taxes under IRC Section 4975
- If the required information isn't disclosed, then contract is not reasonable
- Not reasonable, then the contract violates the prohibited transaction (PT) rules

# *Effective Date*

- July 1, 2012
- Extended due to delays in the publication of the final rule
- This extension automatically extends the participant disclosures to August 30, 2012 for initial disclosures and until November 14, 2012 for the first quarterly statement with required disclosures (for calendar year plans).

# *Final Regulation on Participant Level Fee Disclosures under ERISA Section 404(a)*

- Effective on December 20, 2010
- Applicable on first day of a plan year beginning on or after November 1, 2011
- Based on the final service provider regulations, the participant disclosures are automatically extended to August 30, 2012 for initial disclosures and until November 14, 2012 for the first quarterly statement with required disclosures (for calendar year plans).

# *Participant Fee Disclosures*

## Plan-Related Information

- General information about the plan's investment options
- Administrative expense information (plan level fees)
- Individual expense information (transaction-based fees)

# *Participant Fee Disclosures*

## Investment-Related Information:

- Performance data
- Benchmarking information
- Fee and expense information
- An Internet website address
- A glossary to assist participants with investment terminology

# Timing Rules for Participant Fee Disclosures

Disclosure Deadlines	Type of Disclosure
<b><u>First Disclosures Required in 2012:</u></b>	
<del>May 31, 2012</del> <b>August 30, 2012</b>	First Initial Notice - calendar year or plan year <u>begins by</u> <del>April 1, 2012</del> <b>July 1, 2012</b>
60 days following 1 <sup>st</sup> day of 2012 plan year	First Initial Notice - plan year <u>begins after</u> <del>April 1, 2012</del> <b>July 1, 2012</b>
<del>August 14, 2012</del> <b>November 14, 2012</b>	First Quarterly Notice – calendar year or plan year <u>begins by</u> <del>April 1, 2012</del> <b>July 1, 2012</b>
45 days after end of the 1 <sup>st</sup> quarter in which Initial Notices are required	First Quarterly Notice - plan year <u>begins after</u> <del>April 1, 2012</del> <b>July 1, 2012</b>
<b><u>Subsequent Disclosure Requirements:</u></b>	
On or before eligibility date	Initial Notice
Every 12 months	Annual Notice
Every 3 months	Quarterly Notice



# *Fiduciary Responsibility for Plan Fees*

- ERISA requires plan fiduciaries to act prudently and solely in the interest of the plan's participants and beneficiaries
- Ensure that the plan's fee arrangements with its service providers are "reasonable," and that only "reasonable" compensation is paid out of plan assets for plan services
- Several recent court cases have focused on this "reasonable" standard with mixed results for plan sponsors

# *Understanding Plan Fees*

## Types of Fees:

- Investment (sales charges & advisor management fees)
- Plan Administration (recordkeeping, TPA, etc.)
- Individual Account Service (loans, distributions, etc.)

## Terminology:

- Basis points
- Share classes (A, I, R, etc.)
- Revenue sharing (12b-1, shareholder servicing, Sub-TA, etc.)

# *Understanding Plan Fees (cont'd)*

## *Fee Arrangements:*

- Multiple Scenarios

## *Who Pays the Fees:*

- Plan Sponsor
- Plan Participants

## *Reporting of Fees – Form 5500 Schedule C:*

- Direct
- Indirect
- Non-monetary

# *Preparing for the New Fee Disclosures*

The following actions are recommended:

- Identify service providers & level of responsibility
- Determine all applicable fees that the plan is subject to
- Understand & analyze the fees for reasonableness
- Document the process & conclusions reached
- Discuss expected timing, method and compliance of the disclosure requirements with services providers
- Communicate plan fees with participants
- Establish process to periodically review service agreements for performance

# *Fiduciary Responsibilities*

## Topics:

- Who is a Fiduciary
- Fiduciary Standards
- Fiduciary Duties
- Understanding that a Fiduciary could be Personally Liable
- Fiduciary Compliance Reviews

# *Who is a Fiduciary*

- By Title - any individual who:
  - Is named in the plan document or appointed in accordance w/the document
  
- By Action – any individual that:
  - Exercises control or authority over the management of the plan or the plan’s assets (including disposition of assets)
  - Provides investment advice for a fee
  - Has discretionary authority over the plan’s administration

# *Fiduciary Standards*

- Act solely in the interests of plan participants
- Act with care, skill, prudence, and diligence
- Diversify plan investments
- Act in accordance with the plan document

# *Fiduciary Duties*

1. Identifying & Designating of Fiduciaries
2. Selection and Monitoring of Service Providers
3. Selection and Monitoring of Plan Investments
4. Ensuring the Plan operates in accordance with the Plan document and related administrative policies (protect the rights of plan participants and beneficiary)



# 1. *Identifying & Designating of Fiduciaries*

- Appoint a plan committee(s)
  - Single retirement plan committee or separate committees for plan administrative issues and one for investment issues
- Select appropriate committee members
  - HR, Finance, Legal, and individuals that have decision-making authority

# 1. Identifying & Designating of Fiduciaries

- Establish procedures
  - Adopt written processes / procedures
  - Conduct regular meetings (annual plan admin, quarterly investment reviews)
  - Keep detailed minutes – document attendance, note matters that were considered, record all decisions made
  
- Appoint & confirm trustee
  - Decide if the plan should be self-trusted or if the plan sponsor should engage a corporate trustee

## 2. *Selection and Monitoring of Service Providers*

- Hiring a service provider is a fiduciary function
- Responsibility to ensure that the service provider's services are:
  - Necessary
  - And the cost of those services are reasonable
- The requirement is not to pick the lowest-cost provider but to act prudently and to pay only reasonable fees for the services provided.
- Periodically review the performance of the plan's service providers

# 3. *Selection and Monitoring of Plan Investments*

- Fiduciary is charged with diversifying the plan assets in a manner that minimizes the risk of substantial losses
- Implement an investment process
- Adoption of Investment Policy Statement – sets guidelines and general parameters regarding the various investment types or categories the plan will offer – will include benchmarking each investment to monitor fund performance

### 3. *Selection and Monitoring of Plan Investments*

- Ensure compliance with ERISA Section 404(c) – Under Section 404(c), fiduciaries, in general, are not liable for any losses due to a participant’s choices if the plan:
  - Provides a broad range of investment alternatives
  - The participants exercise control over their investments
  - The plan provides sufficient information to the participants for them to make informed investment decisions & the opportunity to make changes at least quarterly
  
- Provide a robust investment education program

## 4. *Plan operates in accordance w/Plan Document & Administrative Policies*

- Understand plan documents & administrative requirements (enrollment steps, loan policy & QDRO policy, & notice requirements)
- Provisions intended to protect the rights of plan participants – protections include requirements relating to reporting and disclosure, participation, vesting, and funding
- Evaluate & monitor annual plan fees and expenses
- Make EE contributions on a timely basis (DOL SH rule)
- Obtain Fidelity Bond & consider Fiduciary Liability Insurance Policy
- Conduct Annual Fiduciary Compliance Review

# *Retirement Plan Governance*

- Are the right individuals involved?
- Do these individuals know their roles and responsibilities?
- Are there formal processes and procedures in place for carrying out their assigned tasks?
- Is there a process in place for monitoring their assigned tasks?

# *Personally Liable*

- ERISA 409 provides that any “person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this title shall be personally liable to make good to such plan any losses to the plan resulting from each such breach”
- May also be personally responsible for paying any civil penalties or excise taxes imposed under the law



# *Strategies for Minimizing Potential Liability*

- Educate Fiduciaries – need to know their responsibilities and obligations under ERISA
- Fiduciary Insurance
- Written Investment Policy Statement (comply w/404(c) & QDIA)
- Monitor your service providers and their fees (are they reasonable for the services rendered)
- Adopt the Principle of “Procedural Prudence”
- Conduct annual fiduciary compliance review

# *Fiduciary Compliance Reviews*

- Annual ERISA audit – focused on examination of the plan’s financial integrity
- Fiduciary compliance review – focused on determining if the plan meets the required IRS & DOL rules & regulations
  - IRS – main focus is on the plan document and whether the plan is operating according to the document and required tax laws
  - DOL – main emphasis is ensuring that the rights of plan participants are protected

# *Fiduciary Compliance Reviews (cont'd)*

- Plan service providers and responsibilities
- Plan document, policies, procedures & operations
- Plan reporting, disclosures & notices
- Compliance Testing
- Investments, fees & expenses
- Fiduciary due diligence
  - Administrative / investment committee

# *Fiduciary Compliance Reviews (cont'd)*

- What if you find that something is amiss during your annual review?
  - Better you than the IRS or DOL
  - Review the impact of the error
  - Contact and consult w/your service providers, and plan auditor, if applicable
  - Utilize the IRS Employee Plans Compliance Resolution System (EPCRS)
    - Allows plan sponsors to make corrections for failures regarding the administration of your plan while maintaining the plan's tax-deferred status

# 2012 Contribution & Compensation Limits for Defined Contribution Plans

	2012	2011
401(k) & 403(b) Deferrals	\$17,000	\$16,500
401(k) & 403(b) Catch-Up	\$5,500 (unchanged)	\$5,500
SIMPLE Deferrals	\$11,500 (unchanged)	\$11,500
SIMPLE Catch-Up	\$2,500 (unchanged)	\$2,500
Maximum Contribution Limit	\$50,000	\$49,000
Maximum Compensation Limit	\$250,000	\$245,000
Social Security Wage Base	\$110,100	\$106,800
Highly Compensated EE	\$115,000	\$110,000

# *Katz, Sapper & Miller, LLP*

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