Qualified Plan Fee Disclosure – 408(b)2 and 404(a) and

July 1, 2012. That is the effective date for the new Plan Sponsor Fee Disclosures as per the Final Regulations under 408(b)(2). The original version of these rules were proposed by the Department of Labor in December 2007, and strive to "assist plan fiduciaries in assessing the reasonableness of the compensation paid for services and the conflicts of interest that may affect a service provider's performance of services." [1]

Seems clear enough, right? Unfortunately, due to the large number of recent regulations concerning the financial services industry, there has been a lot of confusion. It is understandable: recent regulations include plan sponsor fee disclosure rules under 408(b)(2), participant fee disclosure rules under 404(a)(5), Dodd-Frank and Fiduciary definition regulations proposed (then pulled) last year.

To clarify, this article will focus on the Plan Participant fee disclosure and Participant Fee disclosure regulations, which will take effect in 2012.

408(b)2 Plan Sponsor Fee Disclosure

On or before 7/1/12, all "Covered Service Providers" (CSPs - those who perform services for a Qualified Plan) must notify the Plan Sponsors for whose plans they provide those services, of how much compensation they received from the plan in the prior year. CSPs must also specifically disclose all services performed for the plan, and fiduciary status to the plan, in order to allow the plan sponsor to assess the reasonableness of the fee charged. In addition to disclosing information regarding services and compensation, providers must also disclose any conflicts of interest that exist or may arise.

The 408(b)2 rules are designed to help Plan Fiduciaries fulfill their duty to ensure that retirement plans and plan participants are charged no more than *reasonable* fees by Covered Service Providers and that there aren't any potential conflicts that may affect the provider's performance of its duties.

Most of the platform providers have already begun assuring plan sponsors of their intent to comply with 408(b)2 and send the required disclosure information to Plan Sponsors on or before 7/1/12. In most cases, this assurance has been drafted in such a way as to convey the feeling that little will change in the Plan Sponsor's world, and that the requirements of 408(b)2 will be satisfied after the fees are disclosed. **The reality** is that the new 408(b)2 regulations were created by the DOL to fundamentally change the way fees are assessed, disclosed and regulated, and a failure to comply could result in expensive consequences, for the Plan Sponsor / Fiduciary as well as for the Covered Service Provider.

The Rules

To really understand what is changing, we must take a look at the language of ERISA, specifically the prohibited transaction rules under 406(a). There, you will find the general rule, that the furnishing of services to a plan by a “party at interest” or “disqualified person” (such as someone who is receiving compensation from the plan for services provided) is a prohibited transaction. There is a statutory exception to this prohibited transaction, under 408(b)(2).

In order to fit under the exception in 408(b)(2), (and therefore avoid having the payment of compensation to the CSP fall under the general rule and therefore be a prohibited transaction), the following three parts must all be met:

1) the arrangement must be *reasonable*
2) the services must be *necessary*, and
3) the compensation for those services must be *reasonable*.

This part of the prohibited transaction legislation under ERISA has not really been enforced up to this point, simply because all the information necessary for a Plan Sponsor to make this sort of determination was not available. In fact, even the most astute plan sponsor would have been hard-pressed to gather all the information necessary to ensure that compensation paid to each covered service provider is reasonable. The new 408(b)(2) regulations regarding fee disclosure were promulgated specifically to change that.

The new regulations under 408(b)(2) require the following to be disclosed to a Plan Sponsor:

- Services provided by the Covered Service Provider
- Fiduciary status of that Covered Service Provider
- Compensation paid to the Covered Service Provider

Putting the general rule in ERISA 406(a) together with exception requirements under 408(b)2 and the new regulations thereunder, we find the following: After the Plan Sponsor receives the information above on or before July 1, the plan sponsor must determine whether the compensation was reasonable for the services provided to the Plan. If (1) the Covered Service Provider refuses to disclose compensation, or (2) the compensation is determined by the plan sponsor (author’s note: or auditor?) to be unreasonable, then a prohibited transaction has taken place (because all the requirements of the 408(b)(2) exception to the 406(a) general rule were not met).

If a Covered Service Provider does not disclose once the Plan Sponsor makes a request for the disclosure or does not disclose within the deadline, the new regulations are clear: the Plan Sponsor has 30 days to turn the CSP in to the DOL. In most circumstances, turning the CSP in to the DOL will absolve the plan sponsor from the fees and penalties due to the prohibited transaction. In turn, the DOL has made it clear in the final regulations that the plan sponsor must cease to use that covered service provider’s services in the future.

The consequences of a prohibited transaction can be significant, including, but not limited to, punitive excise taxes, fee disgorgement and other potential liabilities to the Service Provider.

What to Do:

Plan Sponsor / Fiduciaries can protect themselves by being proactive. Request a statement of the services the CSP is providing the plan, and the frequency of those services, have the CSP disclose his / her fiduciary status to the plan, and what the CSP charges for all the services provided. Get this information in written form, to pair with the forthcoming statements of the compensation received.

The Plan Sponsor should implement a process to ensure it receives the promised services, and keeps receiving this information on an ongoing basis. Further, the Plan Sponsor should have some objective way to determine reasonableness of the services provided and compensation paid for those services. Ideally, Plan Sponsors may want to seek the assistance of an outside consulting firm to compare the fees paid in their Plan with those of other similar plans nationwide, i.e. benchmarking.

In short, advisors and Plan Sponsors should prepare now. Plan Sponsors / Fiduciaries should talk with CSPs to ensure their intent to disclose on time, and review the services that the CSP provides the Plan on an annual basis. CSPs need to proactively ensure their services and compensation are reasonable on a plan-by-plan basis. Some Plan Sponsors may wish to engage the help of an outside expert firm, which can provide objective data, with which to determine the reasonableness of the CSPs' compensation.

A note on the Auditor's Role:

Some commentators have opined that it is the role of the Plan Auditor (for those plans subject to Audit) to assist Plan Sponsors through this analysis. There has also been substantial push-back on the issue, and good arguments on both sides.

Importantly, the AICPA Audit Guide notes in the following in 11.20:

> **11.20** If the auditor concludes that the plan has entered into a prohibited transaction with a party in interest, and the transaction has not been properly disclosed in the required supplementary schedule, the auditor should (a) express a qualified opinion or an adverse opinion on the supplementary schedule if the transaction is material to the financial statements or (b) modify his or her report on the supplementary schedule by adding a paragraph to disclose the omitted transaction if the transaction is not material to the financial statements (see paragraph 13.17 for examples of reports). If the client refuses to accept the auditor's report as modified, the auditor should withdraw from the engagement and indicate the reasons for withdrawal in writing to the plan administrator or board of trustees.
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> **- AICPA Audit and Accounting Guide- Employee Benefit Plans Jan 2011**

Note that the opening sentence presumes that the auditor will have done some sort of analysis to conclude "that the plan has entered into a prohibited transaction with a party in interest."

404(a)(5) Participant Fee Disclosure

The above information and analysis becomes more important as one understands the tie-in with *participant* fee disclosures under 404(a)(5).

Officially, the participant-level fee disclosure regulations under this section pertain to fee disclosure from the Plan Sponsor to its Qualified Plan's participants. In essence, the goal is to ensure participants are aware of the fees they are paying for the investment options they can choose among, as well as the fees they are paying for other services, such as investment advisory, education, recordkeeping, legal and accounting. For most plans, participants must be provided with annual and quarterly information about plan and investment fund fees and expenses, both in percentage of assets and in "dollars per thousand" terms. Currently, platform providers are working to ensure compliance with these new requirements.

The Effective date for participant fee disclosure is the later of: (1) 60 days after plan year end, for plans ending after November 2011 or (2) 60 days after the 408(b)2 regulations' 7/1/12 effective date. For most plans, which are "calendar year" plans (ending 12/31 of each year), the effective date of this section will be August 30, 2012.

Bringing It Home

Let's close by painting a picture: John and Jane Smith work at different employers. They both have Mutual Fund "X" available in their respective plans and have chosen it for their own retirement savings. Over the dinner table, they read through their new participant statements, now fully compliant with 404(a)(5) and now disclosing fees that neither of the Smiths knew existed before this. (Research shows that somewhere between 60% and 70% of plan participants think their plan is "free" of any fees and charges).

John's employer's plan charges a lot more fees to his account than Jane's partially because John's plan is smaller, but also because John's employer chooses to have all fees paid out of the plan rather than borne by the employer, and John's account has a large percentage of the plan's overall assets. The cost difference is staggering. Jane pays 1.1% all-in for Mutual Fund X, including the expense ratio and all fees assessed against her account. John pays a little over 3% for the same fund. Needless to say, John is a bit miffed at this, and makes it his first priority the next morning to talk with his head of H.R. about the issue.

The next morning, after a sleepless night adding up and compounding all the years of "paying too much" John gets into the office and storms into H.R.'s office. He asks a simple question – "Did you know that we are paying too much for Fund X in our 401(k)?

How the plan sponsor or the plan sponsor's representative (HR in the example above) chooses to respond to that question may mean the difference between a good explanation to an unhappy employee on the one end, and on the other, a class action law suit, with the plan sponsor as one of the defendants.

Plan Sponsors: get the information and be ready to answer questions.
Plan Advisors: discuss this with your clients.

Authors:

Thomas D. Wyatt, JD CFP
Larry F. Boord, JD CLU ChFC
Steve Haxton, CPA

1. 29 CFR Part 2550 http://www.dol.gov/ebsa/pdf/2012-02262-PI1.pdf