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# W H I T E P A P E R

## **REQUIRED FEE DISCLOSURE TO PLAN SPONSORS**

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# REQUIRED FEE DISCLOSURES FOR PLAN SPONSORS

## Why are fees required to be disclosed?

The Employee Retirement Income Security Act of 1974, as amended (ERISA) is a federal law that governs the operation of most retirement plans. In order to protect plan assets and participants, ERISA prohibits a number of transactions between “parties in interest” and ERISA-covered plans. One who provides services to a plan, such as a plan record-keeper, TPA or advisor is considered a party in interest. Thus, absent an exemption, the plan could not employ these vendors and pay their fees from the plan.

A service provider who engages in a prohibited transaction may be liable to restore the prohibited fees paid to the plan and pay a penalty to the United States Department of Labor (DOL) which administers ERISA. The provider may also be liable for a 15% excise tax on the amount involved in the prohibited transaction, and possibly a 100% excise if the transaction is not corrected.

There is an exemption to this prohibited transaction rule if the contract or arrangement between the plan and the service provider is reasonable, the services are necessary to the plan, and the plan pays only reasonable compensation for the services offered by a service provider. The current DOL regulation explains what constitutes a “reasonable arrangement,” “necessary services,” and “reasonable compensation.” New DOL regulations require that certain disclosures must be made by specified service providers in order for the arrangement to be deemed reasonable.

## What plans are covered by the new rules?

A “covered plan” includes practically any retirement plan subject to ERISA. It does not include government plans, such as government 457 plans or most church plans. Moreover, nonqualified plans generally do not have to comply. Individual Retirement Accounts (including SEPs and SIMPLE plans) are likewise not affected since they are not subject to ERISA.

## What service providers are covered by the new rules?

“Covered service providers” are those providers that reasonably expect to receive \$1,000 or more in direct or indirect compensation during the term of the agreement in connection with providing covered services to a covered plan. It is irrelevant whether the covered services are provided by an affiliate or subcontractor. “Covered Services” are:

1. **Fiduciary Services.** Services provided directly to the plan as an ERISA fiduciary; services provided directly to the plan by a registered investment advisor (RIA); or fiduciary services provided to an investment product that holds plan assets, such as a collective investment trust.
2. **Certain Recordkeeping or brokerage Service.** Brokerage services and recordkeeping provided to an individual account plan that permits participants to direct investments to their accounts (such as a 401(k) Plan), if one or more designated investment alternatives are made available (through a platform or similar mechanism) in connection with those services.
3. **Other Services for Indirect Compensation.** Most other plan services, but only if the service provider expects to receive indirect compensation (further defined below). These services include accounting, appraisal, auditing, banking, consulting (i.e., related to development or implementation of investment policies or the selection or monitoring of service providers or plan investments), custodial, insurance, investment adviser (for the plan or its participants), securities brokerage, third-party administration, and valuation services.

## How are the required disclosures to be made?

**Format.** The covered service provider must provide the required disclosure described below in writing to the plan official with authority to cause the plan to enter into, extend or renew, a contract or arrangement with a covered service provider. This person is referred to as the “responsible plan fiduciary” and is generally the Employer or Plan Sponsor. No particular format is required, although the DOL is considering requiring a summary schedule of key information. Only general categories of services need be provided, but additional disclosures are required for record-keepers as discussed below. Moreover, if the services to be provided are expected to be fiduciary services or services as an RIA, that fact must be disclosed. The disclosures need to be provided in writing, but may be provided electronically with the written consent of the responsible plan fiduciary.

## **What must be disclosed?**

**Description of Services.** The covered service provider must provide a description of the services to be provided to the plan pursuant to the contract or arrangement.

**Fiduciary Status.** Moreover, if the services to be provided are expected to be fiduciary services or services as an RIA, that fact must be disclosed.

**Compensation.** The covered service provider must describe all of the compensation it, an affiliate, or a subcontractor expects to receive. This includes compensation paid directly from the covered plan ("direct compensation"), identified either in the aggregate or itemized service-by-service; and compensation received from any source other than from the plan or the plan sponsor ("indirect compensation"). Note that compensation received from the plan sponsor is not required to be disclosed.

Examples of indirect compensation include float revenue, finder's fees, management fees a mutual fund pays to its investment adviser, shareholder servicing fees, sub-transfer agency fees, 12b-1 distribution fees, and brokerage commissions. Disclosure of indirect compensation must include an identification of the services and the party paying the compensation.

Compensation that is paid among the covered service provider, an affiliate, or a subcontractor is generally not required to be disclosed. However, disclosure is required if the compensation is either transaction-based (e.g., commissions or finder's fees) or is charged against the covered plan's investment and reflected in the net value of the investment (e.g., 12b-1 fees). The disclosure must identify the services for which compensation will be paid and the payers and recipients of the compensation.

Compensation includes non-monetary compensation which is anything of monetary value (e.g., money, gifts, awards, trips). However, non-monetary compensation valued at \$250 or less, in the aggregate, during the term of the contract or arrangement may be excluded. Disclosure of non-monetary compensation at the beginning of the arrangement is problematic. It may be difficult for a financial professional to determine at the start of a services arrangement whether he or she reasonably expects to receive gifts and entertainment during the term of the arrangement, that are allocable to a specific plan and exceed the \$250 threshold. Once such compensation is received or expected to be received, it would have to be disclosed as a change in compensation discussed below.

In addition to disclosing on-going compensation, the regulations require the covered service provider (or an affiliate or a subcontractor) to disclose compensation that may be payable in connection with the termination of the contract or arrangement.

Compensation, whether direct or indirect, can be expressed as a fixed dollar amount, a formula, a per capita charge for each participant, a percentage of the covered plan's assets, or if none of these can be used, any other reasonable method.

Additional compensation disclosures are required for recordkeepers. Aside from disclosing all direct or indirect compensation expected to be received by the recordkeeper, an affiliate or a subcontractor, additional information must be disclosed if all or part of the services are not expected to be covered by explicit compensation, or when compensation for such services is offset or rebated based on other compensation received. In that event, the recordkeeper must explain in detail the recordkeeping services provided, provide a reasonable estimate of the cost to the plan for such services, and explain the methodology and assumptions used in making the estimate. The estimate should take into account full explicit fee the recordkeeper would charge third parties for similar services or the prevailing market rate for similar services for a plan of similar size and type.

## **What investment disclosures are required?**

Covered Service Providers who provide recordkeeping or brokerage services to a plan that permits the participant to direct the investment of their accounts must disclose the following with respect to the investment alternatives (self-direct brokerage accounts and brokerage windows are excluded) made available to the plan:

1. A description of any compensation that will be charged directly against the amount invested in connection with the acquisition, sale, transfer of, or withdrawal from the investment contract, entity, or product (e.g., account fees, deferred sales charges, exchange fees, purchase fees, redemption fees, sales charges, sales loads, and surrender charges);
2. A description of the annual operating expenses (e.g., expense ratio), if the investment return is not fixed; and
3. A description of any ongoing operating expenses in addition to annual operating expenses (e.g., mortality and expense fees, wrap fees).

The same disclosures are required for a covered service provider providing fiduciary services to an investment product, entity or contract holding plan assets.

## **When do the required disclosures need to be made?**

*Initial Disclosure.* The covered service provider must disclose the required information to the responsible plan fiduciary reasonable in advance of when the contract or arrangement is entered into, extended or renewed. If the investment alternatives have not been designated at the time the contract or arrangement is entered into, the investment disclosures must be made prior to when such investments are so designated by the responsible plan fiduciary.

*Disclosure of Changes.* A covered service provider must disclose a change to the information disclosed as soon as practicable, but not later than 60 days from the date on which the service provider is informed of the changes. However, if the disclosure is precluded by extraordinary circumstances beyond the service provider's control, the information must be disclosed as soon as practicable. Note that no materiality standard applies. Any change in the information provided requires an additional disclosure.

*Disclosure Errors.* A covered service provider will not be deemed to have failed the requirements of the regulation merely because of a disclosure error or omission, as long as the service provider acted in good faith and with reasonable diligence, and discloses the correct information to the responsible plan fiduciary as soon as practicable, but not later than 30 days from the date on which the service provider knows it made an error or omission.

## **May the responsible plan fiduciary request additional information?**

The covered service provider must provide additional information requested by the responsible plan or plan administrator that is required for the plan to comply with the reporting and disclosure requirements of ERISA. Primarily, this is the annual report, form 5500. The covered service provider must disclose the information not later than 30 days following receipt of a written request from the responsible plan fiduciary or plan administrator unless such disclosure is precluded due to extraordinary circumstances beyond the service provider's control, in which case the information must be disclosed as soon as practicable. If the covered service provider fails to provide the requested information, the responsible plan fiduciary will not be held liable if he or she notifies the DOL of the failure if the information is not received within 90 days of the request.

## **What is the effective date of the new rules?**

The regulations are effective as to all contracts and arrangements entered into, renewed or extended after January 1, 2012, and as to all contracts and arrangements in existence on January 1, 2012.

## **What are the implications of the new rules?**

The new regulations will allow plan sponsors to better understand the true costs paid to the providers servicing their plan. It will make it easier to compare the costs of the various types of service providers. Conversely, full disclosure of fees will allow those same service providers to more clearly articulate the value of their services vis-a-vis the competition.

Service providers affected by the regulations will need to evaluate their compensation model to see if changes should be made. Arrangements not currently in writing should be expressed in written form. Current disclosures should be reviewed to see whether they must be supplemented and how to do so. In short, they will also need to implement a plan for complying with the regulations well in advance of their effective date.

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**For questions or comments on this article, please contact Steve Sokolic at [ssokolic@bcgbenefits.com](mailto:ssokolic@bcgbenefits.com), or (856) 368-7215. Steve is also an ERISA attorney and is available to lecture on areas of tax, compensation and retirement planning.**

**About the author:**

Steven Sokolic, is Executive Vice President and General Counsel with Benefit Consultants Group. He has a Juris Doctor degree from George Washington University and a Master of Laws degree in Taxation from Georgetown University. Steve is a member of the Pennsylvania Bar. He worked for both the United States Department of Justice and Internal Revenue Service in the field of federal taxation. Steve was a practicing attorney for over 20 years before joining BCG as a tax and retirement plan consultant. Steve has written and lectured extensively in the areas of tax, compensation and retirement planning.