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The August 30 Deadline For Distributing Participant Fee Disclosures Is Upon Us: What To Do Next

The August 30, 2012, deadline for distributing the newly required fee disclosures to participants in most qualified retirement plans (such as 401(k) plans, 403(b) plans, and profit sharing plans) is just around the corner. In April, we sent out a client Alert summarizing these new Department of Labor requirements, which apply to most qualified plans that allow participants to direct their own investments. That Alert can be found here. By August 30, 2012, most plans subject to these new mandates must provide their participants with a wide array of paperwork detailing the investment alternatives offered by the plan as well as the specific administrative- and investment-related fees and expenses that may be charged (directly or indirectly) to participants' accounts.

For these plans – and, for that matter, all qualified retirement plans – another critical date was July 1, 2012. That date represented the deadline by which entities providing services to a qualified plan had to provide detailed written disclosures to the plan's fiduciaries about the various services they perform for the plan and the compensation they receive for doing so. The July 1 service provider disclosures are essential to plan fiduciaries as they evaluate whether their service provider arrangements are reasonable. They are also critical to plan fiduciaries that are subject to the participant fee disclosure mandates, because much of the information in the *service provider fee disclosures* will be necessary to complete the *participant fee disclosures* that must be distributed by most plans no later than August 30.

We understand that some of you may be struggling over what to do with what may be a large pile of paperwork that you have received from your service providers. You are not alone. The task of evaluating these materials is a complex one, and the issues can be tricky for even the most sophisticated benefits specialist. Therefore, in the attached Memorandum, we have attempted to make your life a little easier by outlining some key steps to help you fulfill your legal responsibilities as a plan fiduciary under the new federal regulations. In conjunction with our April 2012 Alert, this new Memorandum identifies *five key steps that plan fiduciaries must take immediately* to ensure that the plans they administer are in full compliance with all of the new participant fee disclosure regulations.

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Very briefly, the five key steps are as follows:

1. **Identify the Plan's Covered Service Providers.** Only "covered" service providers are required to provide fee disclosures to the plan.

2. **Determine Whether the Service Provider Fee Disclosures Are Adequate.** The fee disclosures should include sufficient information to allow the plan fiduciary to do the following:

    - Evaluate the reasonableness of the service provider's pricing;
    - Identify any conflicts of interest; and
    - Satisfy the requirements for the participant fee disclosures (which are described in detail in our April 2012 Alert).

3. **Act Promptly If the Service Provider Fee Disclosures Have Not Been Provided or Are Insufficient.** The plan fiduciary is required to take specific action if any service provider fee disclosures are incomplete, erroneous, or not provided at all. *Failure to follow the prescribed steps will be regarded by the Department of Labor as a breach of fiduciary duty.*

4. **Evaluate the Reasonableness of the Covered Service Provider's Fees.** All of the fees must be "reasonable" – the meaning of which varies depending on the specifics of the plan.

5. **Prepare and Distribute the Participant Fee Disclosures.** The plan fiduciary (which is typically the employer acting as plan administrator) is legally responsible for preparing and distributing the participant fee disclosures. For most plans, including calendar year plans, *the deadline for distributing the participant fee disclosures is August 30, 2012.*

These steps are explained in more detail in the accompanying Memorandum we have prepared. We strongly urge you to read the attached Memorandum.

If you have any questions regarding the service provider fee disclosures or the participant fee disclosure requirements, please feel free to call Eric Namee, Brad Schlozman, or Steven Smith at (316) 267-2000.

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MEMORANDUM

WHAT DO I DO WITH THESE SERVICE PROVIDER FEE DISCLOSURES?

AUGUST 8, 2012

July 1, 2012, was a big deadline for those who provide services to qualified retirement plans. By that date, many service providers had to provide written service provider fee disclosures about the services they perform and the compensation they receive from their plan clients. So qualified retirement plans (such as 401(k) plans, 403(b) plans, and profit sharing plans) should have now received at least one set of written service provider fee disclosures from each of their plans' service providers.

The service provider fee disclosures are essential to plan fiduciaries as they evaluate whether their service provider arrangements are reasonable and as they begin to prepare the newly required participant fee disclosures that *must be distributed by most plans no later than August 30, 2012*. For detailed information on the participant fee disclosure requirements, see our April 2012 Alert which can be found by clicking here.

No doubt many of you are close to pulling your hair out (or worse) over exactly what to do with what may be a large pile of documents that you recently received. Fear not. In this brief Memorandum, we hope to provide you with some guideposts to help you navigate the important responsibilities that have been thrust upon you by the new federal regulations governing these fee disclosures. In tandem with our Participant Fee Disclosure Alert issued in April 2012, this new Memorandum identifies *five key steps that plan fiduciaries must take immediately* to ensure that the plans they administer are in full compliance with all of the new participant fee disclosure regulations.

I. – What is the Purpose Behind the Service Provider Fee Disclosures?

Before we get to the compliance steps, what follows is some very brief background on why all of this matters. ERISA places significant fiduciary responsibility for selection and oversight of plan investments on plan fiduciaries.

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Under ERISA, a qualified retirement plan's fiduciaries are prohibited from entering into contracts or other arrangements with third-parties unless such contracts or arrangements are "reasonable," particularly in terms of the amount of compensation being paid to the service provider. Like beauty, though, exactly what constitutes a "reasonable" arrangement is often in the eye of the beholder. However, one thing that *is* clear is that a fiduciary cannot make a "reasonableness" determination unless it has sufficient information about all the fees that the service provider is receiving for its plan-related work. In the new service provider fee disclosure regulations, the Department of Labor ("DOL") sought to ensure such transparency by mandating significant new disclosure obligations. The deadline for service providers to make these written disclosures to plans was July 1, 2012.

Armed with this mass of new information, fiduciaries must now evaluate the data and decide whether the plan's arrangement with the service provider is reasonable. The stakes are high. If the disclosures have been made and the fiduciary prudently determines that the arrangement is reasonable, the contract can remain in place, the fiduciary is protected from liability, and all is well with the world. But if either the disclosures are not made or the fiduciary concludes that the service provider's compensation is not reasonable, then prompt steps must be taken by the fiduciary to terminate the contract. Failure to do so will cause the fiduciary to have breached its duty under the law and may subject it to substantial liability.

Who are the Plan Fiduciaries?

One might ask: "Who exactly are the plan fiduciaries referred to in this Memorandum?" To answer this question, recall that there are multiple roles for those connected to a qualified retirement plan. There is the *plan sponsor*, which is nearly always the employer. The plan sponsor itself is *not* a fiduciary, except to the extent it selects and monitors the fiduciaries. Then there is the *plan administrator*, who *is* a fiduciary and who is responsible for managing the plan's day-to-day affairs. In most plans, the employer will typically serve as the plan administrator. The *plan trustee* is also a fiduciary and is in charge of overseeing the plan's assets and investment decisions. Although there may be other fiduciaries associated with the plan, for purposes of the service provider fee disclosures and the participant fee disclosures, the plan administrator and plan trustee are the most relevant. To avoid confusion in this Memorandum, however, we will refer to the person/committee/entity that is responsible for fulfilling the requirements of the federal regulations simply as the "plan fiduciary."

II. – What Should You Do With the Service Provider Fee Disclosures?

Step 1: Identify the Plan's Covered Service Providers

The first thing that plan fiduciaries must do is determine whether they have received all of the service provider fee disclosures that they need. Only "covered service providers" are required to provide these disclosures to the plan. In general, a "covered service provider" includes the following:

- Entities that provide services *as a fiduciary* to the plan (for example, an investment manager);

- Entities that provide services *as a fiduciary* to an investment vehicle that holds plan assets and in which the plan has a direct equity investment (for example, the investment manager to a bank common collective trust or an insurance company pooled separate account);

- A registered investment adviser ("RIA") to the plan;

- Platform recordkeepers to the plan (for example, entities that provide recordkeeping and/or brokerage services to a participant-directed defined contribution plan in connection with the provision of the designated investment options, *such as mutual funds*, that are offered to participants under the plan); and

- Any other entity that receives "*indirect compensation*" for the services it provides to the plan. "Indirect compensation" means compensation from sources *other than the plan or the plan sponsor*. (So, for example, if the plan's accountant is paid directly by the plan or the sponsoring employer, it is not indirect compensation and no service provider fee disclosure need be provided by the accountant. On the other hand, if the plan's accountant receives a payment from the mutual fund in which the plan is investing, the accountant is deemed to have received "indirect compensation" and would have to provide a service provider fee disclosure to the plan. The same would be true of the plan's broker who receives compensation from the mutual fund.)

Step 2: Determine Whether the Service Provider Fee Disclosures Are Adequate

Although the service provider fee disclosures can be complex, they must, in general, include the following information:

- A description of the services provided;

- A statement as to whether or not the service provider is a fiduciary or RIA for the plan; and

- A listing of all direct and indirect compensation that the covered service provider and its affiliates and subcontractors expect to receive from either the plan itself or other third-parties for the services being provided to the plan by such covered service provider and its affiliates and subcontractors. This must include any fees that might be triggered in the event the contract is terminated.

This information should be sufficient to allow the plan fiduciary to do the following:

- Evaluate the reasonableness of the service provider's pricing;

- Identify any conflicts of interest; and

- Satisfy the requirements for the participant fee disclosures (which are described in detail in our April 2012 Alert).

Step 3: Act Promptly If the Service Provider Fee Disclosures Have Not Been Provided or Are Insufficient

If a covered service provider either provides an incomplete or obviously erroneous disclosure, or fails to provide a required disclosure altogether, the responsible plan fiduciary *must* take the following steps:

- Immediately request the missing information from the covered service provider. This request must be in writing. *Failure to request the disclosure with all required components will be regarded by the DOL as a breach of fiduciary duty*.

- If the covered service provider does not satisfy this request within 90 days or simply refuses to provide the information, then the plan fiduciary must notify the DOL. The notice to the DOL must be sent within 30 days of the earlier of (a) the covered service provider's refusal to provide the information, or (b) the end of the 90-day period. The DOL has prepared a model notice form on its website. *See* http://www.dol.gov/ebsa/regs/feedisclosurefailurenotice.html.

- If the covered service provider fails to provide the information after the 90-day period has expired, and the information relates to *future services*, then the plan fiduciary must quickly but prudently terminate the service arrangement. This termination should be done soon, but not so soon that it would harm the plan's participants.

- If the covered service provider fails to provide the information after the 90-day period has expired, and the information does *not* relate to future services, the plan fiduciary must decide whether to terminate the service arrangement, considering such factors as the nature of the failure and the cost of securing a replacement service provider.

Failure to take these required steps could result in a breach of fiduciary duty lawsuit, or even worse, the disqualification of the entire plan. That is *not* a scenario you want to happen.

Step 4: Evaluate the Reasonableness of the Covered Service Provider's Fees

As noted above, ERISA permits plans to enter into contracts or other arrangements with third-parties only if the contracts or arrangements are "reasonable." ERISA also allows plan assets to be used to "defray reasonable expenses of administering the plan." Regulators are now giving increasing scrutiny to this issue. Meanwhile, plaintiffs' lawyers have launched a proliferation of litigation over the last few years against plans and their fiduciaries, alleging that the fees paid to service providers are excessive. Some of these cases have been successful; *all* have been very expensive to defend. Don't put yourself in the position of having to defend a lawsuit. Make sure you examine the covered service providers' compensation arrangements carefully and make sure you document the steps you took in doing so.

Bear in mind that the reasonableness of a covered service provider's fees depends in large part on the specifics of the plan. Fees that might be reasonable for a 100-person plan may be grossly unreasonable for a plan with 10,000 participants. Some plans may find it necessary to work with outside consultants to evaluate the reasonableness of their service provider's fees.

Step 5: Prepare and Distribute the Participant Fee Disclosures

As we pointed out in our Alert on the participant fee disclosure regulations in April, the plan fiduciary is legally responsible for the preparation and distribution of the participant fee disclosures. But if, as is often the case, the employer is also serving as the plan fiduciary, it will rarely be in a position to have that information. Apparently aware of this disconnect, the final DOL service provider fee regulations require that covered service providers include in their *service provider fee disclosures* all of the information that is necessary for the completion of the *participant fee disclosures*.

In practice, one of the covered service providers for a plan (for example, a third-party administrator or the plan's stock broker) will often draft the participant fee disclosures for the plan. They are not, however, legally obligated to do so. It is very important, therefore, that responsibility for the preparation of these disclosures be clearly described in the administrative agreement between the plan administrator and the service provider.

Unfortunately, from what we have seen to date, some covered service providers are doing a poor job in preparing participant fee disclosures, often failing to comply with key parts of the DOL regulations. Because the *plan fiduciary* is ultimately on the hook for any deficiencies, it is essential that the draft disclosures are carefully reviewed by the plan fiduciary *before* they are distributed to participants. Do not simply trust that the disclosures provided by the service provider are adequate. Plan fiduciaries would be well advised to consult with experienced benefits counsel as part of this review.

All of this must be done in short order. Indeed, for calendar year plans, the deadline for distributing the participant fee disclosures is *August 30, 2012*. For fiscal year plans, the deadline for distribution depends on the first day of the plan's fiscal year:

- If the first day of the plan year begins in any month other than August, September, or October of 2012, the deadline for distribution is August 30, 2012.
- If the first day of the plan year is August 1, the deadline for distribution is September 30, 2012.
- If the first day of the plan year is September 1, the deadline for distribution is October 31, 2012.
- If the first day of the plan year is October 1, the deadline for distribution is November 30, 2012.

These new participant fee disclosure requirements are extremely complicated, and compliance can be tricky. The DOL has indicated that, for the initial disclosures, a good faith effort to comply will likely be sufficient. As the new quarterly and annual participant fee disclosures come due, though, the DOL has suggested there will be no such latitude. Meanwhile, the DOL has stated clearly that ignorance of the law will not be deemed an acceptable excuse. So start your compliance efforts as soon as possible.

If you have any questions regarding the service provider fee disclosures or the participant fee disclosure requirements, please feel free to call Eric Namee, Brad Schlozman, or Steven Smith at (316) 267-2000.