

FIDUCIARY EDUCATION 101: RETIREMENT PLANS & NEW DISCLOSURE REQUIREMENTS

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Defining the Fiduciary

“A fiduciary is defined as someone acting in a position of trust on behalf of, or for the benefit of, a third party.

... In general, the issue is whether a person has effective control or influence over substantial investment decisions. It is not uncommon for fiduciaries to be unaware of their status.”

From *Prudent Practices for Investment Stewards* by Fi360



What is Required of a Fiduciary

...they act on behalf of participants in a retirement plan and their beneficiaries

- Prudence
- Loyalty
- Exclusive Purpose
- Diversification
- Adherence



Types of Fiduciaries

- “Named Fiduciary” – identified by office or name in plan or trust documents
- Trustee – can self trustee or outsource
- Plan Sponsor – administration & operation



Types of Fiduciaries

- Based on function or role:
 - Those having the authority to appoint members of an investment committee
 - Investment committee members
 - Investment Professional providing advice for a fee
 - Discretion to buy/sell plan investments



DOL Initiative
ERISA Regulation 408(b)(2)
Disclosure of Provider Fees



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Background

- The Department of Labor has been pursuing a variety of regulatory initiatives that have focused on expenses and fee transparency.
- Because the DOL believes that participants with the right to direct their investments should have access to basic information.



Background

“When plan participants were asked whether they pay fees for their 401(k) plan, seven in ten (71%) reported that they did not pay any fees while less than a quarter (23%) said that they do pay fees. Less than one in ten (6%) stated that they did not know whether or not they pay any fees.”

AARP Survey February 2011:
401(k) Participants' Awareness and Understanding of Fees

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Background

“401(k) participants may not have a clear understanding that there are fees associated with their plans. About three in five (62%) are unaware of how much they are paying in fees for their plans, and almost one-third (32%) report that they do not feel knowledgeable about the impact that fees could have on their retirement savings. However, about four in five (81%) believe that the fees charged for investments are very important or somewhat important in decisions about their 401(k) investments.”

AARP Survey February 2011:
401(k) Participants' Awareness and Understanding of Fees

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Fee Disclosure

- Both regulations require disclosure of fees information, but deal with different issues
- “Covered Service Providers” (CSP) have to disclose ALL FEES *to a reasonable plan fiduciary (plan sponsor)* to decide whether a contract with that CSP is a reasonable plan expense
- The other requires plan sponsor to disclose individually fees paid by participants so they can make informed decisions about their investments



DOL Initiative

- Under ERISA & the Internal Revenue Code, contracts between plans & service providers are prohibited unless the arrangement & compensation paid are both “reasonable”
- This exemption was never previously defined
- The new regulations provide guidance on what is “reasonable” to the fiduciary requiring CSP’s to disclose all fees and terms of the arrangement in writing



DOL Initiatives on Fees and Expenses – Participant

- Describes duties of ERISA fiduciaries in a directed investment plan to give information to participants
- Applies without regard to whether ERISA Section 404(c) applies
- Participant disclosure requirements are effective January 1, 2012.



DOL Initiatives on Fees and Expenses – Plan Sponsor

- Form 5500 Schedule C -- modified to require detailed reporting of indirect compensation
- ERISA Section 408(b)(2) regulatory service provider disclosure:
 - Attempts to define what are reasonable fees through disclosure
 - Service provider fees & payments both direct & indirect
 - New effective date – April 1, 2012



Covered Retirement Plans

- All plans subject to ERISA (i.e. 401(k), PS, MP, 403(b) (ERISA), and Defined Benefit Plans)
- SEPS, Church 403(b)'s, and SIMPLE IRA's are not covered
- Welfare plans are not covered (DOL is going to address fee disclosure under separate regulations)



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Prohibited Transaction

- Service provider or other party in interest must not engage in prohibited transactions with program
- Examples include direct or indirect:
 - Furnishing (or receiving) goods, services or facilities
 - Sales, exchanges or leasing (to or from)
 - Lending or other extension of credit (to or from)
 - Certain other self dealing or conflict transactions



Prohibited Transaction Enforcement

Service provider or other party in interest:

1. Must cease activity & transaction must be rescinded
2. IRS Penalty: 15% of amount involved, up to 100% for failure to correct after notice
3. DOL Civil Penalty: 20% of amount involved
4. DOL has primary enforcement & interpretive authority



Do Your Homework

What is the total cost of your plan?

Employers and employees pay both explicit and implicit plan expenses for their 401(k) Plan:

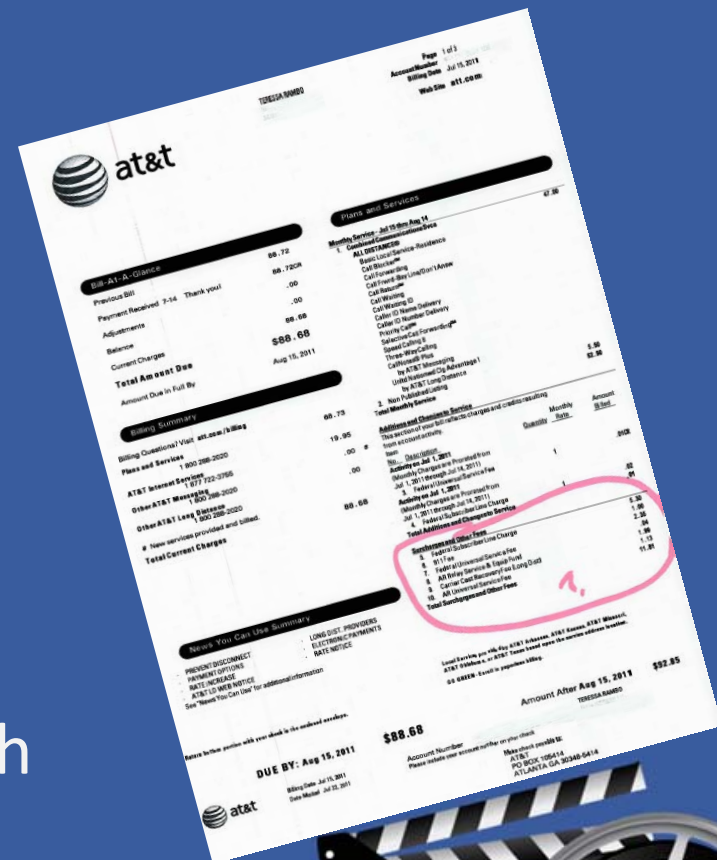
- *Investment Management*
- *12b-1*
- *Plan Administration*
- *Finders Fees*
- *Individual Services*
- *Sub TA*
- *Market Adjustment*
- *Shareholder Service*
- *Custodial*
- *Wrap*



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Like Looking at Your Phone Bill

- What are these charges?
- What are they for?
- What do I get for them?
- How is it decided how much I should pay?



Investment Management Fees

- AKA as fund expenses, investment management fees are the costs associated with managing the plan's assets
- Largest piece of the total cost of the plan
- Usually between 40% to 80% of the total cost of the plan
- Almost always paid by plan participants
- Paid in the form of an indirect charge against the participant's account and deducted from investment returns



Investment Management Fees

- Net total return is the return after these fees have been deducted
- Vary based on fund type, investment style, asset class & fund manager (i.e. retail mutual funds tend to be more expensive than an institutional share class, index funds less expensive than actively managed funds)
- Not always identified on statements & may not be apparent to the employer and employee



Administrative Fees

- Day-to-day operation of a plan involves expenses for basic administrative services such as:
 - Recordkeeping fees
 - Compliance testing (TPA fees)
 - Employee education
 - Required plan document expenses
 - Plan accounting/audit fees
 - Advisor fees
 - Fidelity Bond
 - Trustee services
 - Loan initiation & annual administration



Administrative Fees

- Expenses charged to plan may be assessed pro rata (based on account balance) or per capita (based on equally sharing the expense among all participants)
- Reasonable plan administrative expenses may be charged to accounts of former employees and beneficiaries, even though accounts of current employees are not charged



Individual Service Fees

- Associated with optional features offered under a participant directed account
- May be charged separately to the accounts of those who choose to take advantage of a particular plan feature
- Participant loans, hardship withdrawals, in-service distributions, etc.



Wrap fees / Daily Access Charge

- Mutual funds offered by an insurance company include the mutual fund expense with the underlying management fee AND may include a wrap fee or DAC
- A wrap fee is an additional asset based fee that plan sponsor and participants rarely see



Question

“Are my Plan fees fair for services being provided when compared to similarly sized plans across the country?”



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Best Practices Managing Your Plan

As Plan Sponsor, you are responsible for actively negotiating & monitoring “reasonable” fees - Ask the right questions ...

- What are the fees by component ?
- Request disclosure in dollars as well as a % of assets
- What are the total fees? Both direct & indirect fees associated with the plan. Calculate costs as a % of assets as well as per participant



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Best Practices Managing Your Plan

- Is there revenue sharing in any of the funds?
- Are wrap fees assessed?
- What other revenue sources will impact the plan?
- Use of proprietary funds?
- What might the fees look like in the future as plan assets grow?
- Are there breakpoints?



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Best Practices Managing Your Plan

- **Establish an objective process -- Benchmark your plan**
 - Satisfies ERISA fiduciary responsibility – details all costs and provides documentation in case of DOL audit
 - As assets grow, the leverage a plan sponsor has grows as well
 - Use to bargain/negotiate lower fees from current providers
 - Hire an Advisor who specializes in retirement plans



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What's in a Benchmark Report?

A good benchmark report will include the following:

1. Identifies your Plan's Benchmark Group
2. Plan Fees Summary
3. Fees by Service Provider
4. Investment Lineup Summary
5. Relative Plan Complexity
6. Participant Success Measures
7. Advisor/Consultant Services



Best Practices Managing Your Plan

Put the plan out for bid every three years

- Fees and expenses are not the only consideration!
- No one fund family has all the winners, look at open architecture arrangements, may require switching funds
- Process should be managed by an independent third party who is not compensated by the product and has the expertise



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In conclusion

- Understanding fees & expenses are an important part in managing your retirement plan...

...and your fiduciary responsibility



Thank You

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