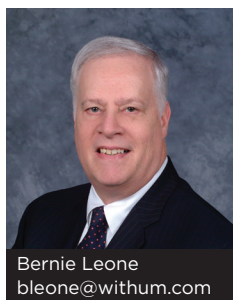
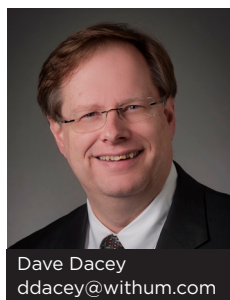


PREPARING FOR THE PERFECT STORM: 401(k) Fee Disclosures

By Bernie Leone, CPA.CITP, Partner
Practice Leader, WS+B Business Advisory Services Group
& Dave Dacey, CPA, Partner
Practice Leader, WS+B Employee Benefit & Pension Plans Group



Bernie Leone
bleone@withum.com



Dave Dacey
ddacey@withum.com

As you are reading this, today may or may not be a sunny day, but in the world of 401(k) plans, a major storm is brewing and the chance for heavy rain is 100%.

You may have even heard about this storm and wondered when it might arrive. Well, it is right around the corner and unless you are prepared, you may find yourself swept away like Dorothy in the Wizard of Oz.

WHAT EXACTLY IS THE FEE DISCLOSURE STORM?

The storm actually comes in two parts. The first part, referred to as ERISA §408(b)(2), involves the requirement that those with fiduciary responsibility for a Plan ensure that a Plan's fees, which are being charged by investment and service providers, are reasonable (more on this later). Under this section, in order to be considered reasonable, a covered service provider is required to provide certain fee disclosures in writing in advance of the contract.

The second part of the storm, which can be much more eye opening to participants, involves the requirement for Plan sponsors to disclose to participants on a quarterly basis, fees and expenses being charged related to their 401(k) plan. This requirement, which was originally effective January 1, 2012, had its effective date for receipt of service provider disclosures revised until April 1, 2012, (and revised again on February 3, 2012 until July 1, 2012). Under this latest revision, Plan administrators for calendar year plans must make their initial annual disclosure of "plan level" and "investment level" information to participants by no later than August 30, 2012, and the first quarterly statement (for fees incurred July through September) must be furnished no later than November 14, 2012.

These quarterly disclosure rules would require:

- **GENERAL PLAN INFORMATION DISCLOSURES** - Such as a list of available investment options, instructions on how to make investments, and information related to administrative expenses.
- **INDIVIDUAL EXPENSE INFORMATION** - Specific to the participant, such as servicing the participant's loan or processing a qualified domestic relations order.
- **WEBSITE LINKS** - For supplemental Plan expense information, which should be posted on the Company's website.
- **CHARTED INFORMATION** - The DOL has provided model charts.

HOW IS THIS STORM DEVELOPING?

The severity of this storm comes in five separate fronts, which are all converging upon each other, causing the inevitable "perfect storm." Just a word about each of these fronts:

1. DOL regulations and revised regulations require the adoption of these fee provisions, currently effective July 1, 2012, with initial annual disclosure of "plan level" and "investment level" information to participants by August 30, 2012 and quarterly participant fee disclosures (for July through September) by November 14, 2012.
2. A Plan's form 5500 is now public information, which is available through EFAST2 filings and services such as BrightScope. The availability of this information makes certain fee benchmarking relatively easy.
3. Precedent-setting lawsuits, such as the recent Wal-Mart settlement of \$13.5 million related to investment options; LaRue Vs. DeWolff, Boberg & Associates, Inc. case, which gave participants the right to sue for breach of fiduciary responsibility; the Tibble vs. Edison International case, which directly challenged the reasonableness of a Plan's fees; and other cases, many of which have been settled, indicate there is more of a chance that members of the Plan's investment committees and certain human resource and financial personnel will be sued for violating their fiduciary responsibility to secure reasonable fees.
4. DOL Enforcement is on the rise - enough said.
5. Participant Fee Awareness is driven by some of the items noted above, causing the storm center to continuously grow.

“The simple truth is that failure to determine in detail what your fees are by definition, precludes you from concluding they are reasonable.”

WHAT KIND OF DAMAGE MIGHT THIS STORM CAUSE?

If you are caught in the storm, there are a wide range of potential penalties ranging from personal liability for those with fiduciary responsibilities, to prohibited transaction disclosure and penalties, to possibly losing the tax exempt status of a Plan. Needless to say, perhaps the most likely penalty of all would be disgruntled Plan participants, who believe that those responsible for Plan administration did not do all that they could to make sure that fees being paid out of participant's assets and earnings are reasonable.

SO WHAT'S THE BIG DEAL ABOUT ENSURING THE REASONABLENESS OF FEES?

The major problem centers around the level of fee and expense detail that is currently provided to Plan sponsors. Even some recent disclosures we have reviewed, which may meet the “spirit of the law” leave a lot of open questions regarding fee details. Unfortunately, it is impossible to determine the reasonableness of fees if they cannot be enumerated. In addition, the DOL in establishing its regulations, which are contained in ERISA §408(b) (2), did not provide either a model form or summary requirement. When questioned about this concern, the DOL stated that it decided not to provide some guidance in order to offer flexibility to the service providers to address the requirement. However, the simple truth is that failure to determine in detail what your fees are by definition, precludes you from concluding they are reasonable.

SO HOW DOES THIS REALLY WORK?

Fees related to a Plan's investments may be comprised of three different categories of expenses: marketing expenses, investment fees, and administrative expenses. In the hypothetical example that follows (taken from a real recent disclosure document with minor changes to protect the innocent), we will look at two of these three categories of fees: investment fees and administrative fees.

Upfront marketing fees paid to an investment advisor should be a “selling expense” and should not be included in any of the fees the Plan sponsor pays, other than those reimbursed by the Plan.

The facts from the disclosure documents we reviewed (which have several details) indicated the following:

1. Annual Administrative Fee: 1.36% of assets
2. Weighted Average Annual Investment Expense (as calculated below): 1.03 % of assets.
3. Total assets: \$11,500,000
4. Funds, assumed allocation, and investment expense ratios:

	Allocation Expense Ratio	
Fund A	\$2,850	.65%
Fund B	\$1,710	1.14%
Fund C	\$1,710	1.15%
Fund D	\$1,710	1.17%
Fund E	\$1,140	1.18%
Fund F	\$1,140	1.29%
Fund G	\$1,140	1.09%
Total	\$11,500	1.03% weighted average

5. Of the 1.03% weighted average annual investment expense, .24% is retained by the investment advisor (the broker who closed the deal) and .79% is retained by the investment provider (in their capacity as the fund's manager). This latter amount is believed to be for the advice provided on investment selection for the participants.

Based on the information in the hypothetical chart, this Plan is paying annual investment fees of approximately \$275,000 (total assets of \$11,500,000 times 2.39% (1.36% + 1.03%).

INVESTMENT FEES

Based upon the information provided, it looks like you have the two key components of Investment Fees. But is this really true? Included in the above, are indirect fees that service providers may receive from funds, which are not separately disclosed, because some would suggest they are subject to confidentiality provisions. Upon inquiry of the investment advisor, we determined that of the .79% investment advisor fee, .29% was paid to a referring broker as an annual investment advisor fee and .50% was paid to the continuing investment advisor, also for investment advice.

ADMINISTRATIVE FEES

It is important to have a thorough understanding of administrative fees. These fees are important because understanding what you are paying for each underlying service allows you to benchmark similar cost of competitor plans. In our example, all we know is that the total annual administrative fee is 1.36%. But what services does that cover?

In Exhibit A, we have included a representative list of possible fees that can be charged to a Plan. Armed with this list, we questioned the Investment Advisor about the components of the 1.36% or \$155,000 and learned the following:

- Third Party Administrator (TPA) fees amounted to approximately \$30,000
- Since this Plan involved movement of an annuity, the fee to pay back the surrender charge from the previous provider amounted to approximately \$52,000
- Bookkeeping\accounting fees comprising the bulk of the balance, amounted to approximately \$73,000
- Withdrawal fees of \$35 were charged to each applicable participant
- IRA rollover fees of approximately \$35 were charged to each participant
- Loan documentation fees of approximately \$8 were charged to each applicable participant
- Loan fees of approximately \$40 were charged to each applicable participant

CONCLUSION

You now have some information and tools, which allow you to better understand the amount of fees your Plan is being charged. With this information, you should request from your investment provider the following items:

INVESTMENT FEES - What is retained by the provider and what is paid to other parties. Is there any portion of investment fees rebated to other parties?

ADMINISTRATIVE FEES -Using Exhibit A (or equivalent) determine from the investment provider, the details included in any administrative fees charged to the Plan.

After developing a detailed profile, that profile can be used to obtain competing proposals or benchmark your fee information, which will allow you to document the decisions you make and the reasons for those decisions.

We believe that after carefully evaluating the Plan's fees, using the concepts included herein, you can "weather the storm" and understand, negotiate, and support the reasonableness of fees related to your 401(k) plan.

EXHIBIT A

1. Investment management - probably included in investment fees
2. Bookkeeping / recordkeeping fees (all direct and indirect - even if not explicitly stated - then need to disclose good faith estimate)
3. Administrative fees
4. Accounting
5. Auditing
6. Actuarial services
7. Appraisal
8. Banking
9. Consulting
10. Custodial (including development of investment policies)
11. Insurance
12. Investment advisory - probably included in investment fees
13. Legal
14. Brokerage
15. Valuation
16. TPA fees
17. Custodial and documentation fees
18. Fees because of acquisition, sale, transfer or withdrawal from investment contract (sales load, sales charges, deferred sales charges, redemption fees, surrender charges, exchange fees, account fees and purchase fees)
19. Annual operating expenses (expense ratio) if the return is not fixed
20. Other fees - wrap, mortality, and expense fees
21. Any fees rebated back by fund companies to the Plan's record keeper
22. IRA rollover fees
23. Loan maintenance / Safeguarding fees
24. Loan origination fees
25. Distribution fees
26. Withdrawal fees

NEED MORE INFORMATION?

If you need more information regarding this or any other topic affecting your retirement plan, visit our Withum ERISA Knowledge Corner online, follow us on Twitter at [WSB_ERISA](#) or contact us at ERISAhelp@withum.com to arrange a free consultation today.

The information contained herein is not necessarily all inclusive, does not constitute legal or any other advice, and should not be relied upon without first consulting with appropriate qualified professionals for your plan's individual facts and circumstances.