What "Fee Disclosure" Rules Really Mean for Plan Sponsors

Part One of a Three-Part Series

Roland | Criss

The New Rules

The new DOL rules will impact plan sponsors equally, if not more than their service providers, and will require an overhaul of the plan sponsor's approach to many formerly rote fiduciary activities.

A Focus on Plan Sponsor Impact

Recent articles addressing the Department of Labor's (DOL) new regulations numbered 408(b)(2) and 404(a)(5) have largely emphasized the impact these rules will have on retirement plan vendors – how they must structure their fees, how and what types of disclosures they will provide, and how their accountability will be altered. Retirement plan sponsors, however, are also inheriting a sea change in their fiduciary role and responsibilities. The new DOL rules will impact plan sponsors equally, if not more than their service providers, and will require an overhaul of the plan sponsor's approach to many formerly rote fiduciary activities.

The emphasis made in commentaries by vendors' associations on the implications of the new rules for their members has inadvertently diminished the focus on plan sponsors' new duties under these regulations. Plan sponsors, for example, now have a responsibility to examine and audit the adequacy of their vendors' fees. The government's unfortunate use of the word "disclosure" as the key word in the new rules disguises the urgency the rules dictate for plan sponsors and their roles.

A real-world vignette best illustrates the challenge plan sponsors face today in understanding the shift in their obligations under the new DOL regulations:

> *A lawyer is having lunch with a friend who is the CFO of a large, national manufacturing company. The lawyer casually brings up how busy he's been addressing the influx of questions from clients regarding the new DOL fee disclosure rules. He says, "It's difficult because my clients now have to make the adjustment from simply receiving fee disclosure statements to actually testing that they are correct and fair." The CFO looks up from his lunch and says, "That doesn't apply to recordkeeping reports, right? I receive those regularly and am diligent about making sure we receive them on time." The lawyer responds, "It absolutely applies to those reports, and you now have an obligation not only to ensure you receive them, but also to test their validity."*

The new rules dramatically augment plan sponsors' existing responsibilities, and this is daunting from three perspectives. First, it is presumed that all plan sponsors understand this shift in responsibility, when, in fact, many plan sponsors currently are as uninformed as the CFO subject in the above scenario. Second, the increase in responsibility requires more of the plan sponsor – more time, analysis, diligence, and accountability – than ever before. Finally, these rules change the landscape for plan sponsors' risk management strategies. In order to maintain regulatory peace of mind, plan sponsors must develop and implement tactics that they have never previously utilized – generating an environment of uncertainty regarding the effectiveness of their go-forward vendor management strategies and regulatory safety. Decades ago, the industrial sector faced a nearly identical challenge. The solution it crafted became known as "supply chain management."

The Call to Action: An Imbalanced ERISA Market Structure

Over the past three decades, there has been an information disadvantage – what the DOL has termed an "information gap" – in the ERISA market between plan sponsors and their vendors. Due to the esoteric nature of investment vendors' processes and offerings, vendors are able to relay certain types of information to plan sponsors and make investment decisions that do not necessarily align with plan sponsors' best interests.

Equipped with a baseline understanding of this issue, the DOL further researched the information gap concern and produced a public report on its findings. The DOL's pointed

language addressing the information imbalance between plan sponsors and their vendors appeared in the July 16, 2010 issue of the Federal Register, an excerpt of which appears below:

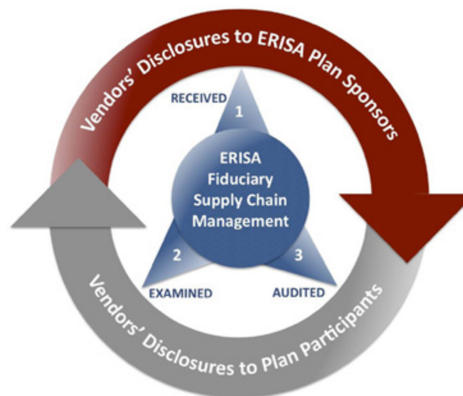
> Vendors are specialists in the design of their products, services, and compensation arrangements, and are continually engaged in marketing to plan sponsors. Plan sponsors often lack this degree of specialization…Vendors have a strong incentive to use their information advantage to distort market outcomes in their own favor. Current ERISA rules hold plan sponsors rather than vendors accountable for evaluating the cost and quality of plan services. And vendors can reap excess profit by concealing indirect compensation (and attendant conflicts of interest) from clients, thereby making their prices appear lower and their product quality higher.

The two new fee disclosure rules – 408(b)(2) and 404(a)(5) – are the DOL's reaction to these findings and its subsequent effort to minimize the information gap before additional damage is incurred by plan sponsors and, more importantly, their plans' participants. Both rules demand that vendors change how they relay information to plan sponsors and participants in order to become more transparent in communicating their services and related fees. However, the rules impose a hefty new responsibility on plan sponsors – requiring them to become more involved and scrupulous with their vendors in order for these rules to have their intended positive effect on the market.

"Fee Disclosure Rule" or "Fiduciary Supply Chain Management Law"?

The oft-used term "fee disclosure rule," referencing the new 408(b)(2) regulation, is somewhat of a misnomer for plan sponsors. The title implies that the primary onus lies on vendors to disclose proper and fair fees to their plan sponsors. This is only part of the rule's dictate. The more important and impactful mandate for plan sponsors are the actions the rule requires of them after vendors' fees have been disclosed.

Specifically, 408(b)(2) requires the following ongoing actions of plan sponsors:



1. **Verify** that they have received the appropriate disclosures from vendors;
2. **Examine** the disclosures to ensure that they are adequate under the new rule; and
3. **Determine** by an "audit" process that the fees provided within the disclosure are reasonable, or fair, given the vendor services rendered.

On the above list, item one (verifying the receipt of vendor fee reports) is the only step most plan sponsors historically have performed. Items two and three (examining vendor

Adopting a New Role

Plan sponsors can find their way during this murky transition in order to excel in their new role and effectively develop their go-forward approach.

reports for compliance with federal law and determining the fairness of vendor fees) are virtually unheard of in this community.

A combination of potentially misleading vendor marketing tactics and a lack of sophistication around the intricacies of the investment vendor market has led the plan sponsor community largely to believe that if "proper" (i.e., brand-respected) retirement plan vendors are selected, then those vendors' practices are ethical and in the best interests of the plan sponsor. The DOL's aforementioned Federal Register report clearly and definitively negates that this is the case.

Due to this predominant brand-respected philosophy, however, plan sponsors have relied heavily on these vendors to make investment and plan management decisions on their (and their participants') behalf – under the presumption that their vendors' reports contain all of the information they need to properly oversee this process. The implementation of the new 408(b)(2) rule turns this assumption on its head by revealing to plan sponsors that a) their vendors may not be acting in their best interest and may be using certain reporting tactics to conceal excessive fees, and b) they themselves are responsible for monitoring and determining the acceptableness of their vendors' behavior.

Hence, it is likely more useful for plan sponsors to consider the 408(b)(2) rule as a "Fiduciary Supply Chain Management Law," rather than a "Fee Disclosure Rule," since the former implicates plan sponsors' proactive role in this new process. Once plan sponsors adopt a proactive mindset, their next impending challenge will be to effectively enact these new strategies that have been largely foreign to this market to date.

From Overseer to Analyst: Adopting a New Role

The three requirements of the 408(b)(2) rule for plan sponsors place them at the forefront of accountability to their plan participants, the rest of their executive team, and the DOL. The sense of security plan sponsors once felt upon receiving their recordkeeper, investment manager, investment advisor or other vendor reports has been replaced by a daunting realization of their responsibility. Even more affecting, perhaps, is the understanding that the trustworthiness plan sponsors once bestowed upon their service providers has been quite radically challenged. Plan sponsors' recognition that previously trusted vendors may not be acting in their best interests, irrespective of vendors' assertions of their adherence to a fiduciary standard, is a hard pill to swallow, particularly for leadership teams who have relied upon the same vendor partners for years, or even decades.

The enactment of these new proactive strategies for plan sponsors is as much of an opportunity as it is a challenge. Plan sponsors finally have been given full reign over determining their retirement plans' futures and ensuring the safekeeping of their plan participants' savings. On the other hand, this newly found holistic perspective burdens plan sponsors further with increased responsibility. They must now employ new strategies with which they do not have previous experience and about which they may feel tentative, if not uncertain.

Plan sponsors can find their way during this murky transition in order to excel in their new role and effectively develop their go-forward approach. The implementation of an annual audit of vendors' fees and arrangements by a licensed fiduciary supply chain manager, a certified training course, or a combination of these three assurance offerings can provide plan sponsors with the confidence and peace of mind they need to successfully move forward under the new regulations.

Stay tuned for Part Two of this series from Roland|Criss, which will be published in December 2011.

2011 East Lamar Blvd., Suite 150
Arlington, TX 76006
Phone: (817) 861-7963
Fax: (817) 861-0568
Toll Free: (800) 440-3457
E-mail: admin@rolandcriss.com
© 2011 Roland|Criss Fiduciary Services

ROLAND | CRISS