# THE EXCELLENT FIDUCIARY

# Will the New ERISA Fee Disclosure Rule Make You a Better Fiduciary?

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**The Tortoise and the Hare**

It is no secret that ERISA retirement plan sponsors have been at a distinct disadvantage when it comes to understanding their vendor's fee arrangements and service structures. This "information gap," as it was termed by the Department of Labor ("DOL"), has gradually broadened since the inception of ERISA, and has provided vendors an opportunity for the deft disguise of exorbitant fees and conflicts of interest. Specifically, the DOL stated in the July 16, 2010 edition of the *Federal Register*, "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."

Until now, with the launch of ERISA's 408(b)(2) rule, this information gap has not been properly monitored or addressed. The evaluation of fees by fiduciaries historically has been driven by their vendors—through the presentation of intricate, multi-page reports that seem to distinguish a vendor's favorable pricing in comparison to its competitors. The combination of this fee complexity and plan sponsors' insufficient training in understanding vendors' products and services has exposed fiduciaries to predatory pricing structures and arrangements from their vendors. Prior to the enactment of 408(b)(2), the legal accountability for testing the fairness of these fees was hazy, at best—and left plan sponsors to trust and rely on their vendors to provide them with adequate reporting and explanation regarding the breakdown of their fee structures. Based on the DOL's *Federal Register* statement referenced above, it is now apparent that this "trusted advisor" approach was far from a best practice amongst the fiduciary community.

**Leveling the Playing Field: The New Requirements**

Now, with ERISA's 408(b)(2) rule, vendors legally are required to make unprecedented disclosures about their fees. The DOL hopes that these new reporting obligations will help to close the information gap and enable fairer fee arrangements between plan sponsors and

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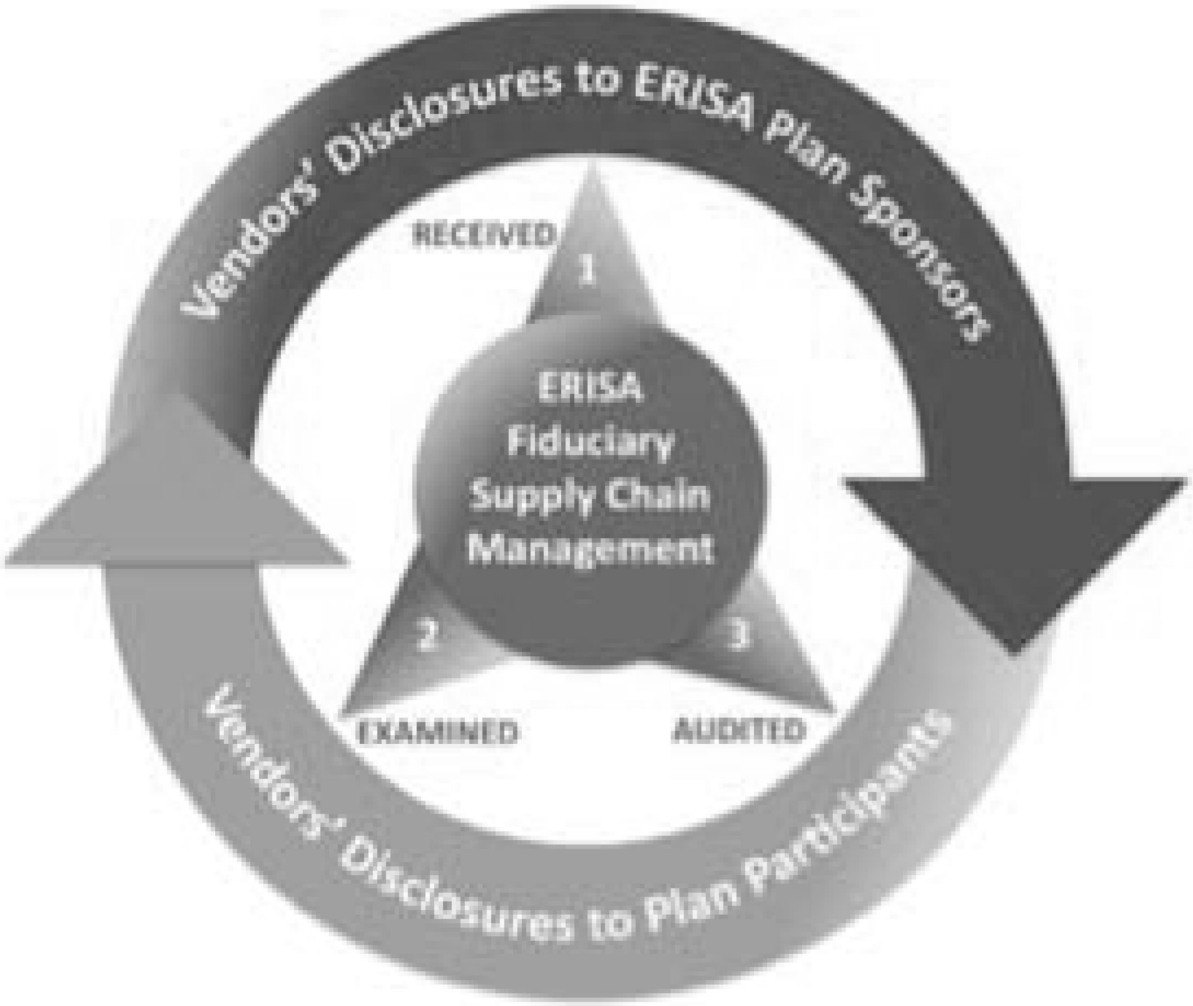
their vendors. Perhaps more interesting than the vendor requirements is what the rule mandates for plan sponsors. Although the term "fee disclosure rule" implies that the burden falls primarily on vendors to alter their reporting and disclosure practices, plan sponsor fiduciaries arguably bear a more imposing legal duty under 408(b)(2).

Gone are the days when merely tracking the regular receipt of a vendor's report seemed an adequate action for fulfilling a plan sponsor's fiduciary duty. Under the new regulation, fiduciaries must handle their vendors' fee disclosures with much more attention to detail, and in a prescribed sequence (as illustrated in Figure A, below). The rule specifically requires that plan sponsors:

1. **Verify** that they have received the appropriate disclosures from vendors;
2. **Test** that these disclosures are adequate under the new rule; and
3. **Determine** that the fees provided within the disclosure are reasonable, or fair, given the vendor services rendered.

*Figure A. Fiduciary Supply Chain Management*



Of the three responsibilities, plan sponsors generally only are accustomed to ensuring the receipt of their vendors' reports (item number one). Requirements two and three—testing the adequacy of the vendors' fee disclosures and then determining whether those fees are fair, given the services provided—pose a significant adjustment and learning curve for plan sponsors. These mandates require much more effort and diligence from plan sponsors than what they previously experienced in their role as fiduciaries. According to the DOL, benchmarking, or simply comparing one plan's fees to a collection of other plans' fees, will not meet the "reasonableness" test. Under the new rule, the quality of the services delivered by each vendor to a plan is of equal importance as the fees charged for these services.

Given this extreme shift in plan sponsor fiduciary duty, coupled with plan sponsors' unfamiliarity with evaluating vendors' fees and services, many plan sponsors will choose to undergo an independent audit of their plan's fees to ensure compliance with the new rule. A fee disclosure audit can help plan sponsors to implement a go-forward strategy that adopts industry best practices for maximizing stakeholder value. In addition, it can be an effective defensive posture for plan sponsors seeking to avoid potential future DOL enforcement actions. Of course, a key success factor in this process will be choosing a firm that specializes in fiduciary practices, and is not connected to a vendor of any other retirement plan services.

## Further Equipping Plan Sponsors: The Benefits of a 408(b)(2) Audit

A failsafe way plan sponsors can embrace fiduciary changes under the new rule and ensure their practices align with industry standards is to enroll in a 408(b)(2) audit. With a slew of new responsibilities to add to an already full plate of leadership duties, plan sponsors will be wise to relinquish (at least part) of their burden to a third party fiduciary partner that can provide them peace of mind around their existing practices and future strategies.

Below are a few of the benefits plan sponsors will reap from participating in a 408(b)(2) audit:

### 1) Clarifying and Updating Vendor Arrangements

While most plan sponsors are familiar with ensuring the receipt of vendor disclosures, many are unfamiliar with testing the adequacy of these vendor documents under the new rule. The first benefit of the 408(b)(2) audit is the vital identification and assessment of existing vendor arrangements. For some plan sponsors who have maintained a longstanding vendor relationship, it is difficult to locate or interpret their original signed contract. Furthermore, many existing vendor arrangements are not defined in writing making compliance with the rule nearly impossible. The audit process enables plan sponsors to fully understand the terms of their vendor contracts, as well as update and revise them, where needed.

### 2) Illuminating What and How Plan Fees Are Paid

Due to the complex nature of vendor fee structures and service models within the retirement plan industry, it is often difficult to discern exactly what fees are being charged for which services, as well as from where those fees are being extracted. A particularly enlightening discovery during the 408(b)(2) audit often is related to learning the ratio of employer-paid fees vs. plan-paid fees Although many plan sponsors assume that fees taken from the company pocket reduce costs for participants, there are many arrangements that generate vendor payments directly from plan assets for the same services—which translates to a reduced amount of investable assets for plan sponsor participants. One of the most valuable takeaways of the 408(b)(2) audit can be understanding and challenging these unbalanced or unfair plan-paid fees.

### 3) Analyzing Vendor Value

The most revolutionary offering that is available with the 408(b)(2) audit revolves around garnering a score that assesses a particular vendor's performance. The audit provides plan sponsors with an objective analysis of their vendors' fees based upon a scientific calculation of value (i.e., services delivered vs. fees rendered over the same specific time period). With this

calculation, plan sponsors not only are able to view fee trends over a certain amount of time (i.e., "we have been overpaying in a particular area of our plan for three consecutive years"), but they are equipped with the knowledge of whether their vendor's fees are "reasonable" as defined by ERISA. This in-depth analysis virtually never has been available to the plan sponsor market prior to 408(b)(2), and is changing the way plan sponsors select and monitor their vendors.

**4) Enhancing Positioning for an ERISA Audit**

A tangible result of the 408(b)(2) audit is that it proves that a plan sponsor is working to adhere to a high level of fiduciary care and comply with the new regulation. The 408(b)(2) audit report stands as firm testimony to a plan sponsor's intention to adequately fulfill fiduciary responsibilities and update policies as needed when regulatory changes occur. The 408(b)(2) audit places in a distinctively advantageous position those plan sponsors that are required by ERISA to obtain an annual CPA's financial audit for their plans.

## Will the New Rule Make Fiduciaries Better?

In the aforementioned 2010 Federal Register publication, the DOL declared that plan fiduciaries have been intimidated by their vendors on such issues as pricing structures and fees. Further, the DOL believes that plan sponsors unknowingly have abdicated their prudence duty to the very organizations that need prudent oversight the most—service providers. Hence, it is up to plan sponsors—not their providers—to take the steps necessary to transition them into an informed position of power, where they are in full control of their plan's future. The new rule hopefully provides the motivation and tools for mobilizing plan sponsors toward elevating their fiduciary practices.

Beyond the beneficial aesthetics of adopting a stewardship-focused fiduciary approach, there is an additional incentive to analyze and improve fiduciary practices: the 408(b)(2) rule has enforcement teeth. The potential enforcement ramifications alone should motivate every leader who occupies a fiduciary seat to pursue an immediate upgrade in their competency. This includes obtaining unbiased input from an experienced fee disclosure audit firm that is able to give an unvarnished perspective on go-forward steps for achieving a secure fiduciary position and leveraging leading industry practices.

The DOL expects that the new rule will lead to better retirement outcomes for U.S. workers. What is the likelihood of this happening? The U.S. workforce only will see tangible benefits if plan sponsors can find a way to effectively fulfill their three obligations under 408(b)(2). Alone, and struggling to find concrete steps for improvement, plan sponsors are not well equipped to navigate this new landscape. Together, working with expert fiduciary support partners in the industry, plan sponsors will be able to improve the quality of the information they use to examine their service providers' fees, jointly test the fairness of those fees, and confidently take the appropriate action to ensure their plan and its participants are ideally positioned—today, and well into the future.