Your Guide to ERISA Fee and Expense Disclosures

A business-first approach to meeting 2012 requirements for Government, Plan and Participant reporting.

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DALBAR
Federal Reserve Plaza
600 Atlantic Ave, FL 30
Boston, MA 02210
617.723.6400
www.dalbar.com

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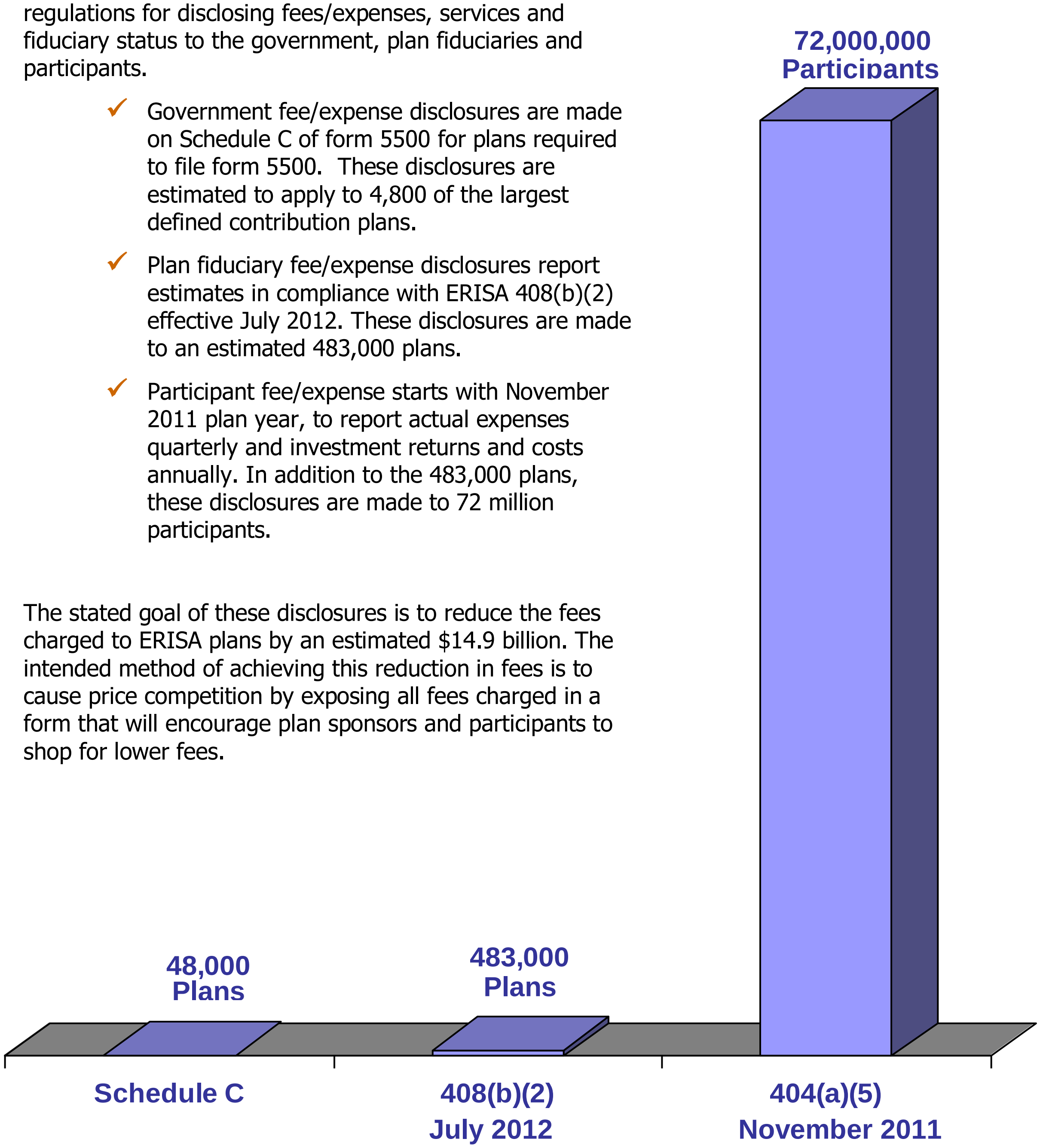
Introduction

What Are the Fee/Expense Disclosure Regulations?

The Department of Labor ("DoL") has issued final regulations for disclosing fees/expenses, services and fiduciary status to the government, plan fiduciaries and participants.

- ✓ Government fee/expense disclosures are made on Schedule C of form 5500 for plans required to file form 5500. These disclosures are estimated to apply to 4,800 of the largest defined contribution plans.
- ✓ Plan fiduciary fee/expense disclosures report estimates in compliance with ERISA 408(b)(2) effective July 2012. These disclosures are made to an estimated 483,000 plans.
- ✓ Participant fee/expense starts with November 2011 plan year, to report actual expenses quarterly and investment returns and costs annually. In addition to the 483,000 plans, these disclosures are made to 72 million participants.

The stated goal of these disclosures is to reduce the fees charged to ERISA plans by an estimated $14.9 billion. The intended method of achieving this reduction in fees is to cause price competition by exposing all fees charged in a form that will encourage plan sponsors and participants to shop for lower fees.



Overview of Requirements

Form 5500, Schedule C requires that certain plans report costs annually to the Department of Labor, the Internal Revenue Service and the Pension Benefit Guarantee Corporation.

The **July 2012 fee disclosure to plan fiduciaries** requires that certain providers described by DoL as "covered service providers" or "CSP" that are paid more than $1,000 must issue a disclosure in compliance with the regulation that details (See CSP Determinator at www.ERISAFeeDisclosure.com for details):

a) all direct and indirect compensation paid by the plan,

b) a description of the services provided to the plan and

c) whether or not the provider is acting as a fiduciary of the plan

Covered service providers include:

- ✓ investment managers
- ✓ advisers
- ✓ recordkeepers
- ✓ brokers and
- ✓ all who receive indirect compensation from the plan

According to the DoL, *"The rule focuses on service providers and compensation arrangements that are most likely to raise questions for plan fiduciaries with respect to the amount of compensation being received by a service provider for plan-related services and potential conflicts of interests that might compromise the quality of those services."*

The **fee disclosure to plan participants** requires two types of disclosures,

a) **plan costs** borne by each individual participant and

b) **investment costs** paid for each investment used

The **plan costs** are reported quarterly in explicit dollars and cents paid by each participant and includes the participant's share of the total plan costs and any other fees charged directly to the participant.

The **investment costs** are shown initially and annually thereafter. Investment costs are shown in basis points and in dollars and cents per $1,000. The investment disclosure must also detail any other potential costs that participants might incur such as sales charges and penalties.

The DoL expects that the Participant Disclosure *"rule will be economically significant"*. In terms of cost increases the DoL says "*The anticipated cost of the rule is $425 million in 2012 (2010 dollars)*" and the cost reductions "*Over the ten-year period 2012-2021, EBSA estimates that the present value of the benefits provided by the final rule will be approximately $14.9 billion and the present value of the costs will be approximately $2.7 billion.*"

Why Should You Pay Attention to the Fee Disclosure Regulations?

The July 2012 fee disclosure regulations put covered service providers in a position where each is required to justify that the compensation received is satisfactory to the plan fiduciary, to the extent that the plan fiduciary pays attention and decides to become actively involved. For plan fiduciaries that do not become involved the burden of the regulation is simply the cost of preparation and distribution of the disclosure materials.

The central issue becomes whether or not plan fiduciaries will become actively involved. If they do become actively involved one can expect that there will be questioning of fees leading to disruptive changes in services, products, advisers and providers.

The argument against the probability of active involvement by plan fiduciaries is the history of disclosures. This history indicated that plan fiduciaries, particularly among smaller plans seldom challenge their service providers. This apathy is understandable, considering that plan costs, except for matching contributions, are typically borne by the participants of the plan. If this apathy remains the case for the fee disclosure regulations, the prudent course of action is to merely comply with the regulations and deal with the few disruptions that do occur in the normal course of business.

This apathetic response would be likely were it not for the Participant Disclosure in which the combination of several new factors could cause a more vigorous response by plan fiduciaries. These new factors and their probable effects are:

Outreach to Every Participant. Unlike the July disclosure that reaches only plan fiduciaries, the Participant Disclosure is delivered to **every participant of every participant directed plan**. The sheer number of participants involved, 72 million, will create a massive response to this unfamiliar communication. The fact that the communication describes fees that most participants believe do not exist, will cause an even higher level of upheaval. Questions of all flavors, from simple inquiries or need for clarification to indignation and even outrage will barrage plan fiduciaries, service providers and advisers.

High Visibility of Fee Disclosures. The Participant Disclosure is most likely to be included with a participant statement to control costs but in doing so, the fee information is packaged with the most often read communication. This will make the disclosure visible to the maximum number of participants and thus cause a large number of participants to question fees.

Disparity in Dollar Fees between High Balance and Low Balance Participants. Plans with asset based fees are disproportionately high for high balance participants who are most likely to be senior executives with considerable influence with plan fiduciaries. These executives are likely to demand a cost structure that does not have them bearing the expense for the low balance participants.

Confusion with Presentation. The comparative disclosure model offered by the DoL was analyzed and found to be confusing to average participants. Use of this model without significant improvements is likely to deluge plan fiduciaries, service providers and advisers with requests for explanations.

Lack of Guidance on a Course of Action. The regulations require that disclosures be made clear but do not require that either plan fiduciaries or plan participants be given guidance on what can be done if they object to the information on the disclosure (fees, services or fiduciary status). This failure to anticipate an expected reaction will likely lead to poor decision making on the part of the plan fiduciary (replace the provider) or the participant (exit the plan).

Why prepare?

If the expectation is that there will be little or no reaction to the Participant Disclosure then there is little preparation required except to train all who might have contact with plan fiduciaries and participants to respond to inquiries about the new documents.

If on the other hand the expectation is that there will be a significant response and possible dislocation then a major effort as described in the next section will be required before either the July 2012 or the Participant Disclosure requirements are made.

Game Changer Paper

For a more detailed discussion of the implications of the fee disclosure requirements please refer to the DALBAR paper, "A Game Changer?" at www.ERISAFeeDisclosure.com. Please contact DALBAR at FeeDisclosure@DALBAR.com or call 617-723-6400 during normal business hours.

Additional Fee Disclosure Considerations

Nothing in fee disclosure regulations protects plan fiduciaries from consequences of:

- ✓ Deceptive practices
- ✓ Omission of material facts
- ✓ Fraud

Compliance with Fee and Expense Disclosure exposes plan fiduciaries to

- ✓ Inconsistent reporting
  - Showing dollars where required but not in other places
  - Showing different fees and expenses on different reports
  - Showing dollars that don't add to same total on different reports
- ✓ Unexplained differences
  - Differences between estimates and actuals
  - Differences between government, plan and participant reports
- ✓ Excessive fees
  - Fees that are not reasonable for comparable services
  - Services that are paid for but not used
- ✓ Inappropriate allocation
  - Portion of fee charged to each participant is out of line with participant's choices… they pick low cost investments but are charged same fee
  - Per capita fee burdens for low balance participants
- ✓ Fiduciary status
  - Conflict with services described

DALBAR Fee Disclosure Services

Supporting Your 2011 Fee and Expense Disclosure Plans with:

- ✓ Decision Support
- ✓ Evaluation of Your Disclosures
- ✓ DALBAR Model Disclosures
- ✓ Plan Service & Fee Evaluation
- ✓ Adviser Services
- ✓ Client Service Tools
- ✓ Participant Surveys

DECISION SUPPORT…

…to make the best choices, to be compliant, to lower costs, to support advisers and to retain clients

EVALUATION OF YOUR DISCLOSURES…

…to ensure that disclosures meet industry practices

DALBAR MODEL DISCLOSURES…

…to present required disclosures in the best light for your firm

PLAN SERVICE & FEE EVALUATION…

…Evaluation that considers fees in the light of services and quality

ADVISER SERVICES…

…to support the adviser through disclosure of services, fiduciary status and compensation

CLIENT SERVICE TOOLS…

…to prepare for the volume of inquiries and concerns about fee disclosures

PARTICIPANT SURVEYS…

…to engage participants in support of plan decisions

Decision Support

Assists in key decisions that:

Create a strong image of being transparent about fees and expenses

Minimize the volume of service issues that develop at the release of the disclosure

Meet regulatory requirements, support advisers and plan sponsors, prepare for client service volumes

Decisions such as:

Pre-notification before regulatory delivery requirement

Linkage of three different fee disclosure requirements

How to prepare for and handle disclosure of fiduciary status

Nature and level of adviser support to be provided

Disclosure differences in various client segments

Disclosure differences with various business partners

Deliverables

Expert review of plans and documents

Decision making workshops led by industry experts

Fees

Minimum fee	$5,000
Hourly rate	$350
Typical engagements:	
Review of plans (20 hours)	$7,000
Review of simple disclosure document (10 hours)	$3,500
Review of comprehensive disclosure document (30 hours)	$10,500
One day decision making workshop (20 hours)	$7,000

Note: Travel expenses are additional

Evaluation of Your Disclosures

Independent Evaluation

The presentation of fee disclosures is an opportunity to communicate a corporate message but it also has the potential to be disruptive or to inadvertently violate other regulations.

DALBAR's evaluation of disclosures used in government reporting (Schedule C), plan fiduciary reporting (408(b)(2) and participant reporting (404(a)(5) provides an important quality and compliance control.

Scope of Evaluations

The specific evaluations conducted are determined using an interview questionnaire that is completed at the start of the evaluation engagement. The following specific evaluations are available:

- ✓ Alignment with industry practices
- ✓ Complexity and readability (Calculated to be understood)
- ✓ Effectiveness in promoting a corporate message
- ✓ Potential for disruptive response
- ✓ Method of proof and reconciliation of all disclosures
- ✓ Potential for regulatory violations and consistency across disclosure types
- ✓ DALBAR Seal and opinion letter, indicating regulatory compliance

Pre-Requisites

In order to complete disclosure evaluations DALBAR will require:

- ✓ An interview questionnaire that describes the goals and parameters
- ✓ Samples of each disclosure (Schedule C, 408(b)(2) and 404(a)(5))
- ✓ Any collateral material used to introduce the disclosure

Fees

Evaluation of:

Schedule C Government Report Only	$5,000
408(b)(2) Plan Fiduciary Disclosure Only	$15,000
404(a)(5) Participant Reports Only	$12,500
Entire Disclosure Set	$25,000

DALBAR Model Disclosures

A Soft Edge to Regulatory Compliance

Complying with fee disclosure requirements without a context or in industry jargon or using regulatory language will compound the problems of the unprecedentedly large scale disclosure.

DALBAR model disclosures are a user-friendly but compliant presentation that helps the reader to understand and properly respond to the disclosures presented.

Applying Industry Best Practices

Models draw from the best practices used in various forms of communication that DALBAR has evaluated since 1990. Practices are incorporated into the model disclosures and further customized to meet the needs of specific firms.

Fast Deliverables

DALBAR has worked on the DoL fee disclosure proposals since they were first proposed and has developed several models that can be quickly transformed to meet specific needs and capabilities.

Customized

Models are prepared to meet the specific objectives, needs and priorities of your firm. Models can encompass a wide variety of functions or can be narrowly focused on a single service. Separate models can be used for different market segments.

Models are adapted to fit corporate image and branding.

Fees

Model Only	$5,000
Multi Service Model (includes 20 hours of customization)	$15,000
Single Service Model (includes 5 hours of customization}	$7,500
Online Interactive Model (includes 20 hours of customization)	$25,000

Note: Travel expenses are additional

Plan Services & Fee Evaluation

Avoid "Race to the Bottom"

DALBAR's evaluation of plan services is a rational and balanced approach for plans to meet the regulatory requirements of evaluating service providers and avoid the race to the bottom that occurs if services are evaluated only on the basis of fees. The evaluation gives weight to all three key considerations:

- ✓ Plan sponsor and participant needs
- ✓ Quality of services
- ✓ Cost comparisons/benchmarks

Benefits to Plan Sponsors

The evaluation provides the plan sponsor with an independent third party evaluation that delivers:

- ✓ Certification that demonstrates compliance with regulations
- ✓ Potential plan cost reduction by eliminating unnecessary expenses
- ✓ Increase benefit of plan by addition of high value features

Translation services are provided for plan fiduciary disclosures (408(b)(2)) and participant disclosures (404(a)(5).

Services

The steps of the evaluation are:

- ✓ Preparation and submission of a plan profile (Plan sponsor or adviser)
- ✓ Analysis, recommendations and certification (DALBAR).
- ✓ Review and acknowledgement (Plan sponsor)
- ✓ Implementation of any necessary changes (Plan sponsor or adviser)

Fees

Fees are determined by the level of service required to support the evaluation. Fees may be as low as $250.

Adviser Services

Adviser Disclosure Requirements

The July 2012 fee disclosure requirement is in conflict with the policies of many broker/dealers and their advisers. The fee disclosure requires each adviser to declare his/her status as a fiduciary if he/she is an RIA/IAR or if fiduciary services, such as investment advice are provided.

RIA/IARs must assume fiduciary responsibilities and obtain the necessary skills and certification to perform at this level for 401(k) plans.

Non-fiduciaries must either become fiduciaries or stop providing services that require fiduciaries under ERISA.

Additionally, plan sponsors are required to demonstrate the prudent decision making process they used in selecting the adviser.

Registered Fiduciary™ Solution

DALBAR's Registered Fiduciary™ solution provides the adviser with:

- ✓ The training required to act as a fiduciary
- ✓ The RF™ designation indicating the fiduciary status
- ✓ The documentation that permits plan sponsors to demonstrate the prudent selection of the adviser
- ✓ Access to independent fiduciaries that can support non-fiduciary advisers

Sponsorship Opportunities

Institutions may sponsor training and certification programs for advisers. Sponsors may choose the advisers who participate and the level of support.

Sponsored programs may be exclusive to one institution or may be supported by multiple firms.

Sponsors maintain high visibility throughout the program and have the right to advertise their sponsorship.

Fees

Fiduciary Training (provided by a qualified training organization -QTO)	varies
Certification as Registered Fiduciary™ (per adviser)	$350
Sponsorship	varies

Client Service Tools

Phone Center Preparation

The Participant Disclosure will create burdens for plan sponsors and spike phone center volumes. These calls will be different from the typical ones because they will likely challenge fees.

In anticipating this volume, providers should divert these calls from plan sponsors and prepare to handle the calls effectively.

DALBAR can support the planning and implementation required to handle the expected peaks.

Phone Center Monitoring

Monitoring of these new types of calls becomes critical to avoid the risk of poor service experiences connected with a challenge to fees. The sensitive nature of these service encounters requires that problems are quickly detected and corrected, especially during peak volumes.

DALBAR Phone Center Monitoring is set up in advance with reporting provided daily or even more frequently to identify problems as soon as possible.

The Monitoring system is adapted to the types of questions expected and revised as unexpected issues arise.

Sponsorship Opportunities

Institutions may sponsor training and certification programs for advisers. Sponsors may choose the advisers who participate and the level of support.

Sponsored programs may be exclusive to one institution or may be supported by multiple firms.

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Fees

Phone Center Preparation… estimate of planning support	$15,000
Phone Center Monitoring (per month)	$5,000

Note: Travel expenses are additional

Participant Surveys

The Coming Cost Sensitivity

The purpose of the massive disclosure regulation is to raise the sensitivity to cost by both plan sponsors and plan participants. This raised awareness will undoubtedly change the behavior of both sponsors and participants. This change in behavior will probably require shedding of variable costs and unbundling of fees.

Plan sponsors and participants that are ill informed are more likely to make poor decisions that injure not only themselves but providers as well. The potential problem is particularly acute with plan sponsors who are currently unaware of current costs and the extent of services and benefits provided.

The coming cost sensitivity creates the opportunity to eliminate unprofitable services. As plan sponsors shift to focus on costs, "keeping up with the Jones'" will take a back seat to finding a cost effective program. This presents a unique opportunity to eliminate services that were added primarily for competitive reasons.

Managing Transformation to Cost Sensitivity

The transformation to cost sensitivity needs to be managed to avoid poor decision-making. Managing the decision-making involves three basic activities that are required for both plan sponsors and for participants.

- Understand the services and benefits currently provided
- Establish the value and cost of each service/benefit
- Present lower cost alternative that excludes some services/benefits

These activities require both teaching and learning from sponsors and participants.

DALBAR Survey Technology

DALBAR offers survey technology that is designed to both learn about preferences and to indirectly instruct both plan sponsors and participants on the decisions and choices available to them. Designed specifically for fee disclosures, providers can learn from sponsors and participants and plan sponsors learn from their employees.

Fees

Surveys pricing consists of a base cost per audience surveyed plus out of pocket expenses such as postage and data entry if applicable.

Single audience cost	$2,500