Business Best Practices

Fee Disclosure Communication: Reality vs. Illusion

"The problem with communication is the illusion that it has taken place."

— George Bernard Shaw

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Never were George Bernard Shaw's words truer than in the current world of 401(k) fee disclosure. By the time this article goes to print, the first round of fee disclosures will be in the hands of plan sponsors and possibly participants as well. Those of us in the industry cannot believe that anyone remotely connected with a 401(k) plan is not already aware of these coming disclosures. However, while awareness may be high among service providers, the details of who, when, and how remain murky, especially in smaller plans. In keeping with our love of quotes, movies, and the enduring value of a quality service provider, we offer the realities of fee disclosure as described in some of our favorite films.

1. Fees in the absence of value mean nothing.

"I never said it would be easy; I only said it would be worth it." Mae West

As Tom Kmak of Fiduciary Benchmarks likes to say, "Disclosing fees without comparing them to the value of the services provided is like saying the score of the game is 14." Plan fiduciaries should determine if fees are reasonable by looking at the services their TPAs, recordkeepers, and advisors are providing for their specific plan. Does the advisor regularly go onsite to several locations enrolling participants? Are there self-directed brokerage accounts that require complicated trust reconciliation? Does the TPA, advisor, or recordkeeper provide 3(38) fiduciary services? Benchmarking is one way to do an apples-to-apples comparison of services, and there are several benchmarking service providers currently doing this work. For the most part, these benchmarking reports are very well done, and they should not be given away for free. If you were a fiduciary, wouldn't it be worth $400 per year to assure that your plans' fees are reasonable? Lastly, if *you* don't offer to benchmark the plan, someone else very likely will.

2. Chasing the lowest fee provider may not be the best fiduciary decision.

"What we do in life echoes in eternity." Russell Crowe in Gladiator

This is the corollary to "fees in the absence of value mean nothing." Selecting a low fee provider who makes compliance testing errors or doesn't follow the plan document—and more importantly, places the responsibility for fixing the errors on the plan sponsor—is a potentially dangerous decision. A provider who charges higher fees, but consistently does quality work using credentialed, experienced personnel is worth the extra cost. Many TPAs are considering offering a "compliance guarantee" as a part of their services to reflect what they are already providing.

3. Employer fee disclosure is an opportunity for a more clearly defined TPA/advisor partnership.

"Louis, I think this is the beginning of a beautiful friendship." Humphrey Bogart to Paul Henreid, Casablanca

Many experts predict a "so what?" effect of fee disclosure on plan sponsors, most of whom are at least somewhat familiar with the new rules. Others have expressed concern that clear, graphic fee disclosure formats that are easier to read will raise more questions than more opaque documents that look like fund prospectuses. Regardless of the outcome, it is essential that the TPA and advisor agree on who is responsible for answering questions from the plan sponsor,

especially when the recordkeeper is separate from the TPA. A note to advisors reading this article: TPAs' fees have not risen in several years, while their administrative responsibilities continue to increase. The average small plan broker or advisor compensation is often four to five times the TPA's cost. Part of the advisor's value will be in helping the plan sponsor decipher the fee disclosure report—and refer to rules 1 and 2 above before recommending the employer change providers.

4. Who will be doing the participant fee disclosure distribution?

"What we have here is a failure to communicate." Strother Martin in Cool Hand Luke

Remember that there are two types of participant fee disclosure: an annual report and quarterly statements. The first annual report will be in participants' hands by August 31 of this year. What is unclear is how those annual disclosure reports will reach the participants. The DOL electronic disclosure rules are so onerous to comply with that service providers will be distributing paper disclosures. However, the ultimate responsibility for distributing the reports rests with the plan fiduciaries. Many small plan sponsors are either unaware of this responsibility or, more importantly, would like to outsource the job to someone else. Service providers are in a unique position to offer distribution of the notices, but they should be charging for it on a per-participant (including those not deferring) basis. The race to the bottom on service provider fees stops now.

5. Participant fee disclosure has real potential for revolt.

"Have fun storming the castle!" Billy Crystal in The Princess Bride

US News and World Report's Money column recently ran an article entitled "How to Take Advantage of New 401(k) Fee Disclosures." The article quoted David Loeper, an advisor with Wealthcare Capital Management: "If you are paying more than half of 1 percent a year, you should be getting some additional services like personal consultations about your particular goals. Consider asking your employer (nicely) to add some more affordable investment choices. It might be helpful to suggest similar funds with lower expense ratios, or that the 401(k) plan offer at least one passively managed index fund." In May, ABC News aired an exposé claiming 401(k) fees were jeopardizing Americans' retirement.

Despite the biased viewpoints expressed in these (and other) media stories, the publicity will raise awareness of 401(k) plan fees among participants, 71 percent of whom in a recent AARP study claimed their 401(k) plans were "free." And, it will only take a few participants with sizeable account balances subsidizing other employees—such as junior partners, physicians' assistants, and mid-level managers—to sound the alarm.

An example of what can happen:

"Within two weeks, employees had launched a Web site on Yahoo!, which had recorded about 1.7 million page views by September 20. The site was developed to allow employees to compare notes and gripe. As they received their personal profiles on the new plan, many long-time employees realized they would be adversely affected. Another site, *www.cashpensions.com*, set up by an employee in Austin, Texas, is packed with information for employees of any company to use to calculate their pensions and contact their politicians."

The time frame? It was September of 1999 when IBM converted to a cash balance plan. A handful of engineers started the Yahoo! site, which eventually resulted in court cases and new legislation governing cash balance plans in PPA '06. Imagine the power of Facebook, Twitter, and LinkedIn in the hands of a few disgruntled participants to broadcast problems with "overpriced 401(k) plans."

6. Do a second "annual" fee disclosure in November to combine all required notices into one package—and charge for it.

"If you build it, they will come." Kevin Costner in Field of Dreams

The employer fee disclosure deadline of July 1, followed by the participant annual fee disclosure deadline of August 31 could inadvertently add two additional dates to the 401(k) plan compliance calendar. Because both disclosures are required annually, many service providers are considering doing a second set of disclosures in November 2012 to reset the annual disclosure clock. This change will allow fee notices to be combined with safe harbor, QDIA, and other required notices that are typically sent out in November.

Given the size and complexity of the annual notice package, especially with fee disclosure added to the notice requirements, service providers should consider a "notice package" fee in addition to their standard administration fees. When most 401(k) administration fees were established, the additional regulatory burdens now required of 401(k) service providers did not exist.

7. IRS examinations are the real issue for small plans.

"It's the fall that will kill you!" Paul Newman in Butch Cassidy and the Sundance Kid

Our good friend and Journal editor, ERISA attorney Ilene Ferenczy, likens the risk of small plan fee disclosure problems to the famous scene in Butch Cassidy and the Sundance Kid where Paul Newman and Robert Redford are stuck between a high cliff above a river and certain capture by the men tracking them. When Robert Redford tells Paul Newman he is refusing to jump off the cliff because he can't swim, Newman laughs uproariously and says, "It's the fall that will kill ya!" In the world of small plans, Ilene points out: "While worrying about fiduciary issues has value, placing all of your concentration there may be missing the point. In our experience, it is much more common for sponsors of small-to-medium-size retirement plans to be subject to an IRS examination than it is for them to undergo investigation by the Department of Labor. And, the chances that there are problems with the plan from a tax perspective are much greater than that there are significant fiduciary liabilities."

8.The future will be rocky, but full of opportunities.

"Fasten your seatbelts. It's going to be a bumpy night." Betty Davis in All About Eve

Several years ago, Australia eliminated all forms of asset-based compensation, including commissions and revenue-sharing. All financial services providers went to a fee-only model. After a difficult transition when fees dropped, prices have consistently risen to reflect the value of services provided. Our industry could see something similar, where forward-looking service providers move to a flat fee model and BPS pricing is slowly eliminated. Many TPAs already price their services on a flat fee basis, and their fees are likely to go up, reflecting the considerable value their services provide to plan sponsors and participants. A more immediate impact in small plans may be a return to the plan sponsor paying the plan fees directly out of the company, and therefore not being subject to the fee disclosure rules. Advisors should be looking to provide fee-based services valued by plan sponsors, such as plan design reviews (in partnership with the TPA(s) and 3(38) fiduciary options).

Fee disclosure may seem like yet another raft of paper that will be mostly ignored by plan sponsors and participants. However, media coverage and plaintiffs' attorneys will keep the issue front and center, especially for participants. The *Tussey v. ABB* case [2012 WL 1113291 (W.D. Mo.)] was brought by an employee represented by a law firm seeking 401(k) participants who were unhappy with their plan. Change in the automotive and tobacco industries was more affected by legal actions after stricter regulations were put into place. In general, legal actions were initiated by lack of transparency and communication. Remember that patients are most likely to sue their doctors when they feel like they were not listened to or, even more simply, didn't like their physicians. Communication, trust, and transparency about 401(k) services will be key in navigating the choppy waters of 401(k) fee disclosure. ■