
Proof of Fee Disclosure -An Example

Plan sponsor review of service
provider arrangements required
by ERISA 408(b)(2)

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Introduction

Plan sponsors in the role of plan fiduciaries to ERISA plans are required to establish that past and future engagements of service providers meet standards of care and prudence. Fee disclosure regulations that take effect in 2012 ("2012 Regulations") define specific factors that must be considered, to establish that engagements are necessary and reasonable. An in-depth analysis of these regulations is presented in the DALBAR paper entitled "Burdens of Knowledge" available in the ERISA Fee Disclosure section at www.DALBAR.com.

Overall Requirements

ERISA § 408(b)(2) requires that plan fiduciaries meet three conditions for service provider engagements:

- **Necessary Service:** Establish that the service is necessary for the successful operation of the plan.
- **Reasonable Arrangement:** Establish that services provided and terms of the arrangement are reasonable.
- **Reasonable Compensation:** Establish that fees and expenses are commensurate with the services provided and the quality of these services.

Content of Example

The example shown in this paper illustrates how the 2012 Regulations are used to meet these three conditions. The example presents the results of an evaluation of one service provider arrangement in six sections:

- **Completeness, Accuracy and Usability:** 2010 Regulations define which service providers must make certain disclosures, what the disclosures contain. Regulations require that Plan Sponsors establish that these disclosures are complete, accurate and usable in meeting the three conditions specified by ERISA § 408(b)(2) above.
- **Success:** It is essential for plan sponsors to determine whether the plan is successfully meeting its intended goals as the basis for establishing the reasonableness required by regulations.
- **Necessity:** Establishing what is necessary for the plan requires that the plan sponsor consider regulatory requirements, success of the plan as well as needs and preferences of plan participants.
- **Comparability:** The external measure of cost is achieved by comparing the current or proposed arrangement to others of similar size, scope and quality that are available.
- **Judgment:** Plan sponsors are required to be prudent in establishing the conditions required by ERISA § 408(b)(2). This is most effectively accomplished through a prudent decision making process that is documented in this section.

Covered Service Providers

The 2012 Regulations introduced the term “Covered Service Provider” to define which firms are required to make disclosures to Plan Sponsors.

The three categories of Covered Service Providers are 1) fiduciaries, 2) providers of record keeping and brokerage services or 3) any service providers that receive compensation indirectly from the plan that is over \$1,000.

Required Disclosure Content

The following is a summary of what the 2012 Regulations require. A more detailed list is provided in Appendix A.

- A description of the services provided
- Service provider’s status as an ERISA fiduciary
- Compensation, both directly from the plan and indirectly
- Manner in which compensation is received
- Record keeping compensation (if applicable)
- Investment fees and expenses (if applicable)

408(b)(2) Fee Disclosure Assessment Example

This example provides a framework for making the required assessments of the 408(b)(2) fee disclosure. It should be used in conjunction with the handbook "*How To Comply With Fee Disclosure, a Plan Sponsors Guide*" (Available on www.DALBAR.com.) This table shown here provides the documentary evidence to establish that a prudent process was used in making the determinations and taking the actions indicated.

Covered Service Provider:		ABC Record Keeping Company	
Date of Assessment:		January 15, 2012	
		Assessment	Explanation/Comment
Completeness, Accuracy and Usability	Disclosure is Complete:	Yes	This disclosure contains a description of services provided, fiduciary status, costs and how they are computed and describes possible conflicts of interest.
	Disclosure is Accurate:	Yes	Total assets, number of participants and total cost is consistent with totals from Schedule C and 404(a)(5) participant disclosure (after adjustments). Disclosure from DEF Investment Services and MNO Plan Advisors are consistent with this disclosure.
	Disclosure is Understandable:	Yes	Very clear presentation, including a summary containing essential information.
	Disclosure is Usable:	Yes	No difficulty finding all needed information in a form that can be used directly.
	Plan Assets in Designated Investments:	\$306,452,980	Provided in disclosure as of 11/30/2011
	Number of Participants:	727	Provided in disclosure as of 11/30/2011
	Total Annual Cost:	\$1,135,254	Provided in disclosure as of 11/30/2011
	Annual Cost per Participant:	\$1,562	Provided in disclosure as of 11/30/2011
Success	Participation Rate:	73%	Obtained from service provider's Website
	Deferral Rate:	4.8%	Obtained from service provider's Website
	% of Participants Projected to Achieve Goal:	56%	Obtained from service provider's Website

Covered Service Provider:		ABC Record Keeping Company	
Date of Assessment:		January 15, 2012	
		Assessment	Explanation/Comment
Necessity	Services Needed:	5	<ol style="list-style-type: none"> Maintain records of Participant accounts and transactions Phone center service for Participants and Plan Sponsors Maintain Website for Participants and Plan Sponsors Develop and prepare educational and enrollment materials Conduct educational and enrollment meeting for Participants
	Quality of Service:	Very High	Positive reaction by participants and no complaints received. Service provider has top rated Website.
	Fiduciary Status:	Non Fiduciary	Services do not include any that require fiduciary status
Comparability	Comparison with other source(s)	\$1,019,500	From proposal made in 2007
	Percentage Difference:	10.2%	The difference is considered reasonable based on the age of the proposal.
	Comparable Cost/source:	\$1,487,320	Calculated from purchased benchmarks using the asset size of this plan
	Percentage Difference:	-31.0%	The plan costs are considerably lower than comparable plans
Judgment	Other Service Providers Referenced:	4	<ol style="list-style-type: none"> DEF Investment Services GHI Trust Company JKL Plan Administrators MNO Plan Advisors
	Potential Conflicts of Interest:	None	Disclosures revealed no potential conflicts of interest.
	Method of Resolving Conflicts of Interest:	N/A	
	Determination of Reasonableness:	Reasonable	Based on the foregoing, necessary services, fiduciary status and costs are acceptable.
	Action Taken:	None	No action is necessary
	Performed By:	John Smith	Vice President, Finance

Appendix A

Required Disclosures

408(b)(2) –Disclosures to Plan Sponsors

(A) Services.

A description of the services to be provided to the covered plan.

(B) Status.

If applicable, a statement that the covered service provider, an affiliate, or a subcontractor will provide, or reasonably expects to provide, services as a fiduciary; and, if applicable, as an investment adviser registered under either the Investment Advisers Act of 1940 or any State law.

(C) Compensation.

(1) Direct compensation.

A description of all direct compensation, either in the aggregate or by service, that the covered service provider, an affiliate, or a subcontractor reasonably expects to receive in connection with the services described.

(2) Indirect compensation.

A description of all indirect compensation that the covered service provider, an affiliate, or a subcontractor reasonably expects to receive in connection with the services described, including identification of the services for which the indirect compensation will be received and identification of the payer of the indirect compensation.

(3) Compensation paid among related parties.

A description of any compensation that will be paid among the covered service provider, an affiliate, or a subcontractor, in connection with the services described if it is set on a transaction basis (e.g., commissions, soft dollars, finder's fees or other similar incentive compensation based on business placed or retained) or is charged directly against the covered plan's investment and reflected in the net value of the investment (e.g., Rule 12b-1 fees); including identification of the services for which such compensation will be paid and identification of the payers and recipients of such compensation (including the status of a payer or recipient as an affiliate or a subcontractor). Compensation must be disclosed regardless of whether such compensation also is disclosed elsewhere. This paragraph shall not apply to compensation received by an employee from his or her employer on account of work performed by the employee.

(4) Compensation for termination of contract or arrangement.

A description of any compensation that the covered service provider, an affiliate, or a subcontractor reasonably expects to receive in connection with termination of the contract or arrangement, and how any prepaid amounts will be calculated and refunded upon such termination.

(D) Recordkeeping services.

Without regard to other disclosure of compensation, if recordkeeping services will be provided to the covered plan--

- (1) A description of all direct and indirect compensation that the covered service provider, an affiliate, or a subcontractor reasonably expects to receive in connection with such recordkeeping services; and
- (2) If the covered service provider reasonably expects recordkeeping services to be provided, in whole or in part, without explicit compensation for such recordkeeping services, or when compensation for recordkeeping services is offset or rebated based on other compensation received by the covered service provider, an affiliate, or a subcontractor, a reasonable and good faith estimate of the cost to the covered plan of such recordkeeping services, including an explanation of the methodology and assumptions used to prepare the estimate and a detailed explanation of the recordkeeping services that will be provided to the covered plan. The estimate shall take into account, as applicable, the rates that the covered service provider, an affiliate, or a subcontractor would charge to, or be paid by, third parties, or the prevailing market rates charged, for similar recordkeeping services for a similar plan with a similar number of covered participants and beneficiaries.

(E) Manner of receipt.

A description of the manner in which the compensation will be received, such as whether the covered plan will be billed or the compensation will be deducted directly from the covered plan's account(s) or investments.

(F) Investment disclosure--fiduciary services.

In the case of a fiduciary to an investment contract the following additional information with respect to each investment contract, product, or entity that holds plan assets and in which the covered plan has a direct equity investment, and for which fiduciary services will be provided pursuant to the contract or arrangement with the covered plan, unless such information is disclosed to the responsible plan fiduciary by a covered service provider providing recordkeeping services or brokerage services--

- (1) A description of any compensation that will be charged directly against the amount invested in connection with the acquisition, sale, transfer of, or withdrawal from the investment contract, product, or entity (e.g., sales loads, sales charges, deferred sales charges, redemption fees, surrender charges, exchange fees, account fees, and purchase fees);
- (2) A description of the annual operating expenses (e.g., expense ratio) if the return is not fixed; and
- (3) A description of any ongoing expenses in addition to annual operating expenses (e.g., wrap fees, mortality and expense fees).

(G) Investment disclosure--recordkeeping and brokerage services.

- (1) In the case of a recordkeeping or brokerage service provider, the additional information described in paragraph (F)(1) through (3) above, with respect to each designated investment alternative for which recordkeeping services or brokerage services will be provided.

(2) A covered service provider may comply with this paragraph by providing current disclosure materials of the issuer of the designated investment alternative that include the information, provided that such issuer is not an affiliate, the disclosure materials are regulated by a State or federal agency, and the covered service provider does not know that the materials are incomplete or inaccurate.