

THORP REED



ARMSTRONG

COUNSEL YOU CAN RELY ON

Fiduciary Duty of Fee Disclosures

Kevin A. Wiggins

412-394-2401

kwiggins@thorpreed.com

- The materials in this presentation are not to be construed as legal advice or an opinion on any specific fact or circumstance. We do not assume any responsibility to update these materials if there are subsequent changes to the law.
- **IRS CIRCULAR 230 NOTICE:** To ensure compliance with requirements imposed by the Internal Revenue Service, we inform you that any U.S. tax advice contained in this communication (or in any attachment) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed in this communication (or in any attachment).

Terminology

- DIA – Designated Investment Alternative
- TAOE – Total Annual Operating Expenses of a DIA

Three Categories of Disclosures

- Automatic
 - Certain times
 - E.g., 90 days after plan entry
 - Certain events
 - E.g., blackout notices
- Upon Request
 - E.g, plan document
- Available for Inspection
 - E.g., plan document

Historical Background

- Trustees' Common Law Duty of Disclosure
- Welfare and Pension Plans Disclosure Act of 1958
 - Plan Description
 - Annual Financial Report
 - Congress felt disclosure was insufficient

Historical Background

- ERISA
 - Part 1 of Subtitle B of Title I of ERISA
 - ERISA Sections 101 – 110.
 - SPD - Automatic
 - SMM - Automatic
 - Form 5500 – Upon Request
 - SAR - Automatic
 - Statement of Vested Accrued Benefits - Automatic

Historical Background

- New Disclosure Requirements Since ERISA
 - Largely driven by growth of individual account plans and “safe harbors”
- PPA Added At Least Ten New Disclosure Requirements

Historical Background

- Fiduciary Duties of Disclosure Under ERISA
- Department of Labor Participant Disclosure Requirements

Participant Fee Disclosures

- 29 C.F.R. § 2550.404a-5
- Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans

Effective Date

- Annual Disclosures
 - Due August 30, 2012
- Quarterly Disclosures
 - Due November 14, 2012

Plans Subject to Fee Disclosures

- “Covered Individual Account Plans”
 - Individual Account Plans
 - Simple Plans and SEPs Excluded
 - Participant Directed Investments

For the First Time, Workers will Receive:

- Core investment information in comparative format to help comparison shop
 - Comparative chart
- Uniform investment information regardless of investment product, allowing for “apples-to-apples” comparisons
- At least quarterly statements showing fees actually deducted from their accounts

Who Has Duty of Disclosure?

- Plan Administrator
 - Identified in Plan Document
 - If Plan Document does not designate, the plan sponsor is the plan administrator
- Administrator may delegate disclosure obligations
 - Duty to select and monitor prudently

To Whom Are Disclosures Required?

- Anyone who has the right to direct the investment of their individual account under the Plan

Disclosure Framework

- 2 types of disclosures
 1. Automatic
 2. On-request
- 2 types of automatic disclosures
 1. Annual
 2. Quarterly
- Disclosures required to comply with ERISA Section 404(c)

Annual Disclosures - Timing

- On or before date of first ability to direct investments
 - Preferably with first communication
 - Date of Plan Entry
 - Survivor Beneficiary
 - Alternate Payee
- All required disclosures due annually except expenses actually charged.

Annual Disclosures - Timing

- At least annually thereafter
 - Once in any 12-month period

Quarterly Disclosures - Timing

- Once in any 3-month period
- Quarterly disclosure requirements apply only to expenses actually charged

Categories of Disclosures

- General Plan-Related Information
- Plan-Wide Administrative Expenses
 - General description due annually
 - Expenses actually charged due quarterly
- Individual Administrative Expenses
 - General description due annually
 - Expenses actually charged due quarterly
- Investment-Related Information

General Plan-Related Information

- An explanation of the circumstances under which participants and beneficiaries may give investment instructions
- An explanation of any specified limitations on such instructions under the terms of the plan, including any restrictions on transfer to or from a designated investment alternative
- A description of or reference to plan provisions relating to the exercise of voting, tender and similar rights appurtenant to an investment in a designated investment alternative as well as any restrictions on such rights

General Plan-Related Information

- An identification of any designated investment alternatives offered under the plan
- An identification of any designated investment managers
- A description of any “brokerage windows,” “self-directed brokerage accounts,” or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by the plan

Plan-Wide Administrative Expenses

- Explanation of any administrative expenses which maybe charged on a plan-wide basis against accounts
 - Recordkeeping expenses
 - Audit expenses
 - Legal expenses
- Not expenses reflected in the TAOE

Plan-Wide Administrative Expenses

- Basis on which plan-wide administrative expenses will be allocated among accounts (e.g., pro rata, per capita)

Individual Expenses

- Explanation of any expenses charged against accounts on an individual, as opposed to a plan-wide, basis
 - Plan loans
 - QDROs
 - Investment advice
 - Etc.
- Not expenses reflected in the TAOE

Changes to Information

- Changes due 30 – 90 days in advance of the effective date of the change
- For example, if the plan is amended to impose QDRO fees, advance notice must be furnished

Quarterly Statement of Expenses Actually Charged

- At least quarterly, a statement of plan-wide expenses actually charged
 - Include a description of services
 - If applicable, explain expenses paid by TAOE
- At least quarterly, a statement of individual expenses actually charged
 - Include a description of services

Other Issues for Plan Information

- Latest information available to plan
- New participants can receive most recent annual disclosures plus updates
 - No need to re-invent the wheel every time
- Information prepared by administrator must be written in a manner calculated to be understood by the average plan participant

Investment-Related Information

- Regarding each designated investment alternative
 - Not investments selected through brokerage window
- Must be in comparative chart or similar format
 - Model comparative chart in appendix to regulations

Investment-Related Information

- Name and type or category of investment
 - Large cap stock
 - Money market
 - Etc.
- Variable rate of return
- Fixed rate of return

Variable Rate of Return

- Performance Data
 - (1, 5, and 10-year returns)
- Benchmark returns over comparable period
- Fee and expense information
 - Shareholder-type fees
 - Description restrictions or limitations on purchase, transfer, or withdrawal (such as round trip, equity wash, or other restrictions)
 - TAOE expressed as a percentage (*i.e.*, expense ratio), as provided on the investment's Form N-1A, Form N-3 or N-4

Variable Rate of Return

- Fee and expense information (cont.)
 - TAOE expressed as a dollar amount for each \$1,000
 - A statement that fees and expenses are only one of several factors that should be considered
 - A statement that cumulative fees and expenses can reduce benefits and that participants or beneficiaries can visit the Employee Benefit Security Administration's Web site to see long-term effect

Variable Rate of Return

- Web Site Address
 - Name of DIA's issuer
 - DIA's objectives or goals
 - Principal strategies and principal risks
 - Portfolio turnover rate
 - Performance data at least quarterly or more frequently if required by law
 - Fee and expense information

FIXED RATE OF RETURN

- Performance Data
 - Annual rate of return
 - Term of investment
 - If issuer can adjust rate
 - Current rate of return
 - Minimum rate guaranteed (if any)
 - Statement that issuer can adjust rate prospectively and where to obtain more information

FIXED RATE OF RETURN

- Fees and Expense Information
 - Shareholder-type fees
 - Commissions, surrender charges, etc.
 - Description of any restriction or limitation that may apply to a purchase, transfer, or withdrawal in whole or in part

Fixed Rate of Return

- Web Site Address
 - Name of DIA's issuer
 - DIA's objectives or goals
 - Performance Data at least quarterly or more frequently if required by law
 - Fee and expense information

Annuities

- The name of the contract, fund, or product
- The option's objectives or goals
- The benefits and factors that determine the price
- Any limitations on the ability of a participant or beneficiary to withdraw or transfer amounts allocated to the option and any fees or charges applicable to such withdrawals or transfers
- Any fees that will reduce the value of amounts allocated by participants or beneficiaries to the option, such as surrender charges, market value adjustments, and administrative fees

Annuities

- A statement that guarantees of an insurance company are subject to its long-term financial strength and claims-paying ability
- An Internet Web site address that provides:
 - Name of the option's issuer and of the contract, fund, or product
 - A description of the option's objectives or goals
 - A description of the option's distribution alternatives/guaranteed income payments, including any limitations on the right of a participant or beneficiary to receive such payments
 - A description of costs and/or factors taken into account in determining the price of benefits under an option's distribution alternative/guaranteed income payments
 - A description of any limitations on the right of a participant or beneficiary to withdraw or transfer amounts allocated to the option and fees or charges applicable to a withdrawal or transfer
 - A description of any fees that will reduce the value of amounts allocated by participants or beneficiaries to the option

Disclosures Upon Request

- Prospectuses or similar documents for investments not registered w/SEC
- Financial statements or reports, if provided to plan
- Statement of the value of a share or unit in each DIA and valuation date
- List and value of assets in portfolio of a DIA that is a look-through entity

Manner of Furnishing

- Annual information can be included in SPD or benefit statement
 - Timing of participant disclosures trump timing for SPD
- Quarterly information can go in benefit statement

Manner of Furnishing

- Department of Labor Electronic Disclosure Safe Harbor
 - Integral part of duties
 - Consent
- IRS Electronic Disclosure Safe Harbor
- Continuous Access Web Site
- Technical Release 2011-03R

Standard of Care

- Some courts hold 404(a) requires disclosures
 - 3rd Cir., 7th Cir., and 8th Cir.
- Other courts may limit disclosures to ERISA Sections 101 – 110
 - 4th Cir., 5th Cir., and 6th Cir.
- But distinguish among categories of disclosures
 - *Varity v. Howe*, 516 U.S. 489 (1996).

Standard of Care

- “A violation of ERISA's disclosure requirement, which arises under ... ERISA § 404(a)(1) ... requires evidence of either an intentionally misleading statement, or a material omission where the fiduciary's silence can be construed as misleading.”
 - *Howell v. Motorola, Inc.*, 633 F.3d 552, 571 (7th Cir. 2011).

Standard of Care

- DOL Standard for participant disclosures

“A plan administrator will not be liable for the completeness and accuracy of information used to satisfy these disclosure requirements when the plan administrator reasonably and in good faith relies on information received from or provided by a plan service provider or the issuer of a designated investment alternative.”

QUESTIONS?

THORP REED



ARMSTRONG

COUNSEL YOU CAN RELY ON

Kevin Wiggins
Thorp Reed & Armstrong, LLP
One Oxford Centre
301 Grant Street, 14th Floor
Pittsburgh, PA 15219
412-394-2401
kwiggins@thorpreed.com