The Best Way to Prepare for Fee Disclosure

Keeping participants sufficiently informed about the plan and the investment options.

By Robert McAree, John Graham, and Tupper Hillard

On November 1, 2011, a new era of transparency will begin when sponsors of participant-directed DC retirement plans will be required to present the fees associated with their plans in one document, which they must share with plan participants. This mandatory disclosure is the third leg of guidance on fee disclosure issued by the Department of Labor (DOL) in the past several years (the others being Form 5500 Schedule C reporting and service provider disclosure). The new rules require plan sponsors to provide participants and beneficiaries with sufficient information to make informed decisions about their investment choices so they can more properly plan for retirement.

The rules apply to all participant-directed ERISA individual account plans effective for plan years beginning after October 31, 2011. Note that there is a 120-day transition period for compliance that begins on the date that the new disclosure rules first apply to a plan. Thus, an existing plan with a November 1 plan year must comply by February 28, 2012.

To be ready for the deadline, plan sponsors must understand the new regulations in the context of their fiduciary obligations, which include:

- Managing the plan and investing prudently,
- Holding assets for the exclusive purpose of providing benefits and defraying reasonable expenses of administration,
- Administering the plan solely in the interest of the participants, and
- Keeping participants sufficiently informed about the plan and the investment options.

Managing a participant-directed DC retirement plan is a dynamic process. Plan sponsors must continually review and evaluate their plans. This means scrutinizing the plan fees, evaluating the investment lineup, providing oversight of the administration and recordkeeping, and assessing plan design features. The objective is to ensure all elements are in line with the organization's retirement goals and objectives.

Communicate and Educate

The DOL regulations require plan sponsors to disclose two types of information: details about the retirement plan itself and information about the investments.

To be truly effective and informative, disclosure must go beyond statements and definitions and provide context and benchmarks to educate participants about investment alternatives and considerations when comparing investments and choosing among them.

Plan sponsors are responsible for providing information to plan participants in a clear manner that shows and explains terms such as expense ratio (a measure of what it costs an investment company to operate a mutual fund, usually expressed in basis points, a unit equal to 1/100th of 1.00 percent). This can be done by explanation, or even better, through demonstration. Participants need information in a form that is usable and understandable. Because individuals have varying levels of knowledge and communication preferences, assume that they need to be educated and communicated with through multiple media or channels. These include clearly written definitions and descriptions, summaries of frequently asked questions, seminars, phone support, and website access. Communications tools already in place, such as newsletters and blogs, can be used to provide supplemental messages to the formal process.

To prepare for disclosure, basic plan information can be found in enrollment kits, summary plan descriptions, mutual fund prospectus, and fact sheets. Information is also available from service providers: the plan's third party administrator (TPA) or recordkeeper, investment manager, independent investment consultant, or investment advisor.

Most major service providers have the communication staff and internal capability to fulfill sponsors' needs for communication. Yet it is important to use more than generic templates. To truly communicate and educate plan participants — and work effectively with their partners to customize communications for the audience — sponsors need

Checklist of Communications Essentials

Overall Objectives

- Provide consistent, understandable and repetitive messaging
- Discuss objectives and benefits
- Emphasize the importance of retirement planning
- Emphasize impact
- Ensure content meets participants' needs

Disclosing Costs

- Provide data in a readable, user-friendly format — it is not enough to merely describe, it is also important to show through helpful exhibits, charts and comparisons
- Anticipate participants' questions and issues and have responses ready
- Show how the plan compares to others in industry or trade, if available
- Provide fee information in a way that will help them assess the reasonableness of fees
- Help them understand why the plan is competitive within the industry/market

Methods

- Ensure appropriate communications mechanisms and processes are in place
- Prepare an "Answers to FAQs" document
- Verify that the service provider is prepared to address participant questions
- Verify that the service provider has retooled its systems to provide the appropriate information required under the regulations in advance of the effective date
- Prepare a fee disclosure statement to give to new participants
- Make sure links to investment websites are in place and the content is appropriate

Bottom Line: Inform, Educate and Ensure Participant Understanding!

to understand their plan, its objectives, the costs and fee structure, the investment options and, most importantly, the profile of the participants.

Every DC plan is unique and has its own rules, investment alternatives, and participant demographics. Plan sponsors need a thorough grasp of these elements to be prepared to communicate information in a form and format that is meaningful to participants and advantageous for the organization.

Review Plan Objectives

An important first step is to consider the organization's objectives for offering a DC plan. These can serve as a compass to help focus the disclosure communications and frame them for different employee segments in the workforce.

One strategy is to think about plan design in the broader context of why the organization offers the plan. Most sponsors view their retirement plan as pivotal to their employee value proposition. Accordingly, the retirement plan becomes an important component of both competitive positioning and workforce planning. It can be used to attract, motivate, and retain talent. For example, the plan may have an enhanced matching formula that serves as an important attraction device. It may offer a longer vesting schedule as a retention mechanism.

If an objective is to provide a retirement plan that is competitively superior, then disclosure communication should play up this top-tier status. The plan's advantages can be highlighted by clearly stating choices, providing and explaining the ongoing due diligence the company performs to keep the plan competitive. It is important to consider how disclosure information can be conveyed so employees understand that the company is looking out for their best interests. For example, more sophisticated investors may appreciate the variety of investment choices while the less seasoned may prefer stable value or target date/lifecycle funds.

Know the Plan's Cost Structure

Communicating fees and expenses in an uncomplicated manner is the cornerstone of the participant disclosure rules. Plan sponsors need to know and understand all the various fees associated with the recordkeeping and administrative services and the investment-related fees that can be assessed to participants. The latter include managing and operating fees, sales charges, wraps, mortality risk and administrative expenses, 12b-1 fees and sub transfer agency fees.

Fees and expenses can have a huge impact on a participant's account balance. A one percentage point difference in investment management fees and expenses may result in a decrease of up to 28 percent in an overall account balance over 35 years.

Beyond just understanding the fees, it is important to consider them from the participants' point of view and be prepared to communicate them in a way that will help them understand how to weigh fees and expenses when making investment decisions.

Providing just enough fee information to be compliant is a disservice to participants. The plan's cost structure should be explained in a readable, usable format that provides not just the data, but also the context. It is not enough to tell participants what the investment options and costs are. The data must be conveyed in helpful exhibits, charts, and comparisons that go beyond the DOL provisions. In this regard, best practices entail a focus on comparative projected outcomes associated with contribution and investment related decisions. Outcomes are best communicated in context of relative retirement income adequacy to reinforce the retirement objectives of the plan.

Plan sponsors should anticipate participants' questions and issues and address them upfront. It goes back to understanding the participant demographics and the type of information participants will require to make informed choices. Basic information is not enough.

Provide Plan Benchmarks

Once the plan sponsor has a handle on plan demographics and costs, the third essential set of data points involves comparisons to other plans. This information will help the sponsor assess the reasonableness of fees and, when shared with participants, can help underscore the value of the plan.

The new participant fee disclosure regulations provide an opportunity to make sure the costs associated with the organization's plan are in line with similar plans in the industry or trade. To conduct such comparative analysis, best practices recommend using a third party resource to assure complete and independent analysis. Plan sponsors can also do their own research using sources such as BrightScope, PSCA, and/or ask the plan's service provider to provide investment options and fees associated with administration and recordkeeping versus other plans.

Renegotiate Fees if Appropriate

Transparency may usher in participant questions about administrative fees, recordkeeping fees, and the availability of share classes for plan investment options. Knowing that participants will be seeing cost information in a more consolidated, usable format may cause sponsors to reassess or evaluate the application of fees and expenses. If the comparisons show fees are not as competitive as they could be, sponsors can be proactive and engage in fee negotiations with their service providers.

This can be an opportune time to obtain bids from other service providers, analyze those bids and decide whether a change is necessary. It is important, however, to remember that making a change can be time-consuming and laborious. If the current arrangement is mostly satisfactory, it may be wise to try to resolve any vendor issues and renegotiate fees as appropriate.

Document All Plan Changes

All changes to the plan, from the selection of a service provider to plan design changes, must be well documented and consistent with the plan's investment policy. Further, these changes should be clearly communicated to participants.

It is a good practice to use an investment committee to oversee plan operations, including internal and external reviews, management and activity reports, the selection and ongoing monitoring of the service provider, investment options and fees, and administrative services and fees.

Develop a Disclosure Checklist

Establishing a project plan will help plan sponsors stay on track with planning as the deadline looms. The project plan should include a list of steps to take along with who is responsible for each step and the date by which it must be completed. The steps in a project plan should include the following:

- Review and understand plan sponsor and participant fee disclosure regulations,
- Determine and document current plan administrative and investment management fees,
- Perform benchmarking study to assess competitiveness of current fees,
- Review benchmarking study and determine if committee wants to renegotiate with the current service provider and document in investment committee meeting minutes,
- Undertake a formal competitive bid process to ensure optimal plan pricing (optional),
- Contact service provider update on system enhancements to provide fee disclosure information,
- Work with current service provider to establish a formal strategy for communicating fee information to participants that includes a set of FAQs,
- Review service provider's participant fee disclosure statement and confirm for accuracy,
- Release FAQs to plan participants and confirm both HR/employee benefits and the service provider are prepared to address participant questions,
- Ensure service provider has trained its service staff to address participant questions on fee disclosure,
- Review annual plan sponsor fee disclosure statement, and
- Continue to monitor plan administrative and investment management fees ongoing.

Conclusion

Plan sponsors must ensure their organization is ready to provide all needed information to participants on a timely basis and then present it in a manner that facilitates their decisions about their retirement plan. For many employees, determining the direction of their DC retirement plan is among the most important financial decisions they will make. A well-thought-out strategy for implementing the new participant fee disclosure regulations is essential in meeting the requirements of the new regulations and providing participants with the information they need to understand and appreciate the plan and make informed decisions.

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