

# 408(b)(2) fee disclosures

## What retirement plan sponsors need to know

Although much of the onus of the Department of Labor's 408(b)(2) regulation falls on retirement plan service providers, plan sponsors have additional responsibilities as well.

In an effort to help protect employer-sponsored retirement plan participants, the Department of Labor (DOL) has taken a number of steps to help both:

- Increase the transparency of costs service providers charge against a plan (reducing what's available for participants) in return for services rendered
- Help the sponsor ensure that the fees being charged are reasonable

One of these efforts is the 408(b)(2) fee disclosure regulation which requires plan service providers to furnish plan sponsors with written, upfront:

- Statement of services to be performed by each service provider associated with the plan
- Fee disclosures detailing the various types of direct and indirect compensation the provider expects to receive

Plan sponsors will likely find the additional information they receive to be of interest and is not something they should simply file away. Since plan fiduciaries must know all plan fees and determine if they are reasonable, they will need to analyze the additional information.

### What is 408(b)(2)?

The Employee Retirement Income Security Act (ERISA) allows the payment of service provider fees from plan assets only if the services are necessary for plan operations and the fees are reasonable. In addition, 408(b)(2) regulations require the services be provided under a "reasonable arrangement." To qualify as a reasonable arrangement in the past, the service contract or

arrangement needed only to allow the plan sponsor the ability to terminate the contract at any time and on reasonably short notice. To qualify under the current regulations, the service provider is also required to furnish the plan sponsor with the fee disclosures before the date the service contract or arrangement takes effect.

In addition, the regulations obligate service providers to notify plan sponsors of any changes to the information in the fee disclosures within 60 days after the change. The rules also allow service providers 30 days after the plan sponsor makes a written request to supply any other fee-related information the plan requires to comply with any of its ERISA reporting and disclosure obligations.

Not satisfying the regulation's requirements could prove costly for service providers. Failure to furnish necessary information or giving false or insufficient statements could lead to substantial IRS excise tax penalties. In addition, the provider may:

- Have to reimburse the plan for any service fees the plan wrongfully paid in violation of ERISA's prohibited transactions rules
- Be subject to a 20% DOL civil penalty

The table next page shows required content for 408(b)(2) fee disclosures.

How the compensation—whether direct or indirect—is disclosed can vary as long as the method is reasonable and it permits the plan fiduciary to determine whether the fees are reasonable. In general, if a provider receives indirect compensation from multiple sources, the provider will be required to disclose separately the compensation payable from each source along with the payer's identity. For example, if the provider furnishes advisory services, it might receive:

Item	What it is
Services	Description of services to be provided to the qualified plan according to the arrangement or contract, if applicable
Fiduciary status (if applicable)	Statement indicating whether services the service provider, affiliate, or subcontractor performs will be provided as: <ul style="list-style-type: none"> <li>• An ERISA fiduciary</li> <li>• A registered investment advisor (RIA)</li> <li>• Both an ERISA fiduciary and a RIA</li> </ul>
Direct compensation (compensation paid directly from the plan)	Description of the total direct compensation reasonably expected in return for services rendered by the covered service provider, affiliate, or subcontractor
Indirect compensation (compensation received from a source other than the plan or the plan sponsor)	Description of all indirect compensation reasonably expected along with an identification of related services provided and the compensation's payer
Compensation among related parties <sup>1</sup>	A description of such compensation along with: <ul style="list-style-type: none"> <li>• Identification of related services</li> <li>• Payer of the compensation</li> <li>• Recipients of the compensation (i.e., provider, affiliate, or subcontractor)</li> </ul>
Compensation upon termination	Description of any compensation reasonably expected upon termination of the contract or arrangement
Manner of receipt	Description of how the compensation will be received (invoice, deduction directly from plan assets, etc.)
Investment disclosure	Information about: <ul style="list-style-type: none"> <li>• Any sales charge or redemption fees</li> <li>• Annual operating expenses</li> <li>• Additional ongoing expenses, such as a wrap fee or a mortality and expense fee</li> </ul>

<sup>1</sup> Required only if compensation paid among the covered service providers, affiliate, or subcontractor is transaction-based compensation (commissions, etc.), fees, or fees charged directly against the plan's investments' net value (12b-1 fees, etc.)

- 12b-1 fees from the plan's investment funds
- Revenue-sharing payments based on the plan's total assets from the plan's administrator
- A wrap fee, which is offset by the 12b-1 fees and revenue-sharing payment, invoiced directly to the client

In this case, the fee disclosures would need to include the required information concerning the 12b-1 fees and the revenue-sharing program—even though the client pays a wrap fee.

## What it means for plan sponsors

As previously mentioned, the 408(b)(2) regulations mean more work for service providers. In addition, plan sponsors need to be aware of the following:

**Your fiduciary responsibility for ensuring that plan fees are reasonable have increased.** The DOL expects plan sponsors to use the fee information they receive as a tool to better ensure that the fees service providers charge are reasonable given the services being rendered.

**If you don't receive sufficient information, you'll need to request more.** Although it's up to the service provider to furnish the additional information, it's the plan sponsor's responsibility to determine whether it has enough to make an informed decision. If you don't think a service provider has given adequate information for you to decide whether its fees are reasonable, you'll need to go back to the provider for the information you need.

**You should use the information furnished to help choose the best service providers.** When selecting a provider, you should always consider the scope and quality of the services provided. Simply choosing the cheapest provider could, in fact, be a breach of fiduciary responsibility if that's not the best decision for the plan. This means you'll need to take the time to fully understand the fee information provided to help you make the choice that's most beneficial for plan participants.

**Pay special attention to indirect compensation arrangements.** In today's highly specialized environment, it's typical to see compensation flowing from one provider to another as a result of alliances and informal partnerships formed among different types of providers. It will be up to you to determine whether these arrangements are truly beneficial to the plan and do not present a conflict of interest.

## Next steps

As plan sponsors, it is up to you to ensure you're prepared to fulfill your fiduciary responsibilities to interpret the information you receive and to make determinations that are most beneficial to plan participants. For more information about plan sponsors' fiduciary responsibilities, ask your Financial Advisor for one of these reports:

- "Reporting Retirement Plan Compensation"
- "Understanding Your Fiduciary Responsibilities"
- "Qualified Retirement Plan Checklist"



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