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CLIENT ALERT

Employee Benefits Update July 2012

New Department of Labor Regulations
Require Immediate Action by Companies that Sponsor 401(k) and Other Retirement Plans

Companies that sponsor 401(k) and other retirement plans have a new set of responsibilities to plan participants beginning July 1, 2012. On that date the first of two new fee disclosure regulations from the U.S. Department of Labor (DOL) become effective. *These new regulations require immediate attention*; otherwise the companies risk participant lawsuits, as well as IRS and Department of Labor scrutiny and penalties.

Briefly, the new disclosure responsibilities are:

- <u>Disclosure by Service Providers</u>. *By July 1, 2012*, all companies or individuals that provide services to a 401(k) plan (or other retirement plan) must disclose to the company that sponsors the plan any fees that are paid directly or indirectly from the plan. What's new for many service providers (such as investment advisers, insurance agents and record keepers) is the disclosure of indirect fees, which include fees in the nature of bonuses for placing assets with particular mutual fund families and special processing fees. The plan sponsor, which has always had the responsibility for making sure the fees are reasonable, will have engaged in an ERISA prohibited transaction if it does not receive and review the fee information.
- <u>Disclosure to Participants</u>. *By August 30, 2012*, plan sponsors must begin disclosing to plan participants who direct the investment of their accounts among various funds (which is the case with almost all 401(k) plans) detailed information about investment fees and performance for funds available under the plan.

Some of the risks to the plan sponsor if proper disclosure is not given are:

- If the plan sponsor does not receive the fee disclosure information from its service providers, it cannot determine if the fees are reasonable. This violates the plan sponsor's responsibility to ensure that the fees are reasonable and could result in fiduciary liability for the plan sponsor.
- If the plan sponsor does not receive full fee disclosure information, it must request it. If it does not receive it within 90 days, the plan sponsor is required to notify DOL and to fire the service provider as soon as it can prudently do so. Failure to take these steps is an automatic fiduciary violation that could result in fiduciary liability for the plan sponsor.
- If the plan sponsor does not provide participants with disclosure of the fees applied to their accounts, the plan sponsor could be sued by certain participants who are unhappy with the performance of

their investments. The claim would be that the participants would not have invested in the funds they chose if they had received the required disclosures.

- Accountants may not give a clean audit for annual reports (Forms 5500) for plans that do not comply with disclosure and reasonableness requirements.

The new rules apply to ERISA plans (including pension plans, profit sharing plans, 401(k) plans and most 403(b) plans) but do not apply to governmental and church plans.

At a minimum a plan sponsor should:

- Confirm that all required disclosures have been received from all service providers who receive at least $1,000 of fees from plan assets (which include many record keepers, brokers, and registered investment advisors (RIAs). (If a service provider has not made the disclosure, the plan sponsor must demand a disclosure within ninety (90) days and, if not provided, must terminate the relationship and must notify the Department of Labor.)
- Make sure the plan has a written contract with the service provider. Besides fees, there are many other provisions of an agreement that should be closely reviewed. Absence of a written contract may automatically result in a determination by accountants that the agreement is not reasonable.
- Determine whether the fees are reasonable. Putting the arrangement out to regular competitive bidding is one way to determine reasonableness. An interim approach (between bids) is to use an independent benchmarking service to provide comparisons of fees and services for plans of similar size and characteristics.
- Document the steps taken to review the contract. Plan sponsors are fiduciaries who must act prudently, and adequate documentation of the review process creates a presumption of prudence.

The above process is critically important because a plan sponsor (or a plan committee with delegated authority) that does not take the required action has engaged in a prohibited transaction that may result in personal fiduciary liability and participant claims against the plan sponsor and other plan fiduciaries.

If you have any questions about this Alert, please feel free to call (919-781-4000) or e-mail your Wyrick Robbins contact or one of the following members of our Employee Benefits & Executive Compensation group: **Richard Rogers** (rrogers@wyrick.com) or **Gray Hutchison** (ghutchison@wyrick.com).