

# Retirement PLAN news

## Service provider fee disclosure

In February, the DOL issued the long-awaited final regulations for the service provider fee disclosure. As responsible plan fiduciaries, employer-sponsors of qualified retirement plans are required under ERISA to make informed decisions about the “reasonableness” of the fees the plan pays for the services it receives. The information that service providers must now provide will help simplify that duty.

### Plan fiduciaries

ERISA imposes strict rules on plan fiduciaries. First and foremost, they are required to act prudently and solely in the interest of the plan’s participants and beneficiaries when selecting and monitoring service providers and plan investments. This means that fiduciaries must ensure that arrangements with a plan’s service providers are reasonable, that only reasonable compensation is paid for the services the plan receives, and that there are no substantive conflicts of interest that may affect the service provider’s performance. Otherwise, a plan may violate ERISA’s prohibited

transaction rules, which govern the relationship between a plan and a “party in interest,” such as a fiduciary or a person providing services to the plan (including, but not limited to, a recordkeeper, trustee, or investment advisor).

Plan sponsors need to know which fees the plan is paying so they can make informed decisions about services, costs, and service providers. Sponsors also need the information so they can comply with another requirement of the fee disclosure regulation: the participant-level fee disclosure.

### Covered service providers (CSPs)

The disclosure requirements apply to “covered service providers” (CSPs). Included on the list of CSPs are:

- ERISA fiduciary service providers to a covered plan or to a “plan asset” vehicle in which such plan invests
- Investment advisors registered under federal or state law
- Recordkeepers or brokers who make designated investment alternatives available to the covered plan (e.g., a “platform provider”)
- Providers of one or more of the following services to the covered plan



who also receive “indirect compensation” in connection with such services: accounting, auditing, actuarial, banking, consulting, custodial, insurance, investment advisory, legal, recordkeeping, securities brokerage, third party administration, or valuation services

The requirements apply to CSPs that expect to receive fees of at least \$1,000 from the plan over the term of the service agreement.

*(Continued on page 2)*



# Highlights of the final service provider fee disclosure regs

**Initial disclosure requirements.** To help uncover potential conflicts of interest, a covered service provider (CSP) must name any company (“payer”) that provides direct or indirect compensation and describe the arrangement between the payer and the CSP, an affiliate, or a subcontractor. Such payments from third parties, rather than from the employer or the plan trust, are defined as indirect compensation.

**Disclosing changes to investment information.** Changes to investment-related information need only be disclosed at least annually. However, changes affecting anything else in the initial disclosure must be disclosed within 60 days after the CSP learns of the change.

**Request for information.** If a plan fiduciary requests disclosure information for reporting or other purposes (such as Form 5500), the CSP must provide the information reasonably in advance of the date by which the plan fiduciary or covered plan administrator states the CSP must comply.

**Compensation to include reasonable and good faith estimate.** A description of compensation or cost may be expressed as a monetary amount, formula, percentage of the covered plan’s assets, or a per capita charge for each participant or beneficiary; or, if the compensation or cost cannot reasonably be expressed in such terms, by any other reasonable method. If the CSP cannot otherwise readily describe compensation or cost, the description may include a reasonable and good faith estimate and an explanation of the methodology and assumptions used to prepare such estimate. Any description, including any estimate of recordkeeping costs, must contain sufficient information to permit the plan sponsor to evaluate the reasonableness of the compensation or cost.

**Electronic communication.** CSPs may furnish required disclosures electronically, including making the information available on a secure website, as long as responsible plan fiduciaries are notified about how to access such information. However, unless the disclosure information on a website is readily accessible to plan fiduciaries and the responsible plan fiduciaries have received clear notification about how to gain access, the information on the website may *not* be regarded as furnished in compliance with the regulation.

**Fee disclosure time frame.** If the required fee disclosure is not timely provided by the CSP, to avoid a prohibited transaction, the responsible plan fiduciary is required to request the missing disclosure from the CSP. If the disclosure is not received within 90 days of the written request, the responsible plan fiduciary must terminate the service agreement.

## Service provider fee disclosure (Continued from page 1)

### Changes for the better

In recent years, changes in the way employee plan services are provided have improved efficiency and reduced the costs of administrative services for both plans and participants. Yet these same changes have made it more difficult for plan sponsors to determine how service providers are being compensated for the specific services they deliver. Under the final regulation, service providers must disclose the actual cost of each service provided.

### Prohibited transaction exemption

There are a number of statutory exemptions from ERISA’s prohibited transaction rules, one of which exempts a responsible plan fiduciary should the plan’s CSP fail to provide the required fee information. To qualify for the exemption, the fiduciary must request in writing that the CSP furnish the required disclosure information. If the CSP fails to provide the information within 90 days after the written request, the final regulations require that the plan fiduciary *must* terminate the service arrangement with the CSP “as expeditiously as possible.”

### Covered plans

The service provider fee disclosure regulation covers defined benefit and defined contribution plans, such as profit sharing and 401(k) plans that cover common-law employees (rather than just the owners of the business). Plans that are not covered include governmental plans, non-electing church plans, plans maintained outside the United States primarily for nonresident aliens, unfunded excess benefit plans, SEPs (Simplified Employee Pension plans), SIMPLE IRAs, IRAs, and non-ERISA 403(b) plans. Note that the regulation does not currently cover welfare benefit plans.

### Effective date

The final regulations extend the effective date of the service provider fee disclosure regulations from April 1, 2012, to July 1, 2012. Since plan sponsors need CSP fee information before they can comply with the participant-level fee disclosure rules, that effective date has also been delayed. Sponsors of calendar-year plans ending December 31, 2012, must provide participants with the first annual fee disclosure by August 30, 2012, and the first quarterly fee and expense statement showing amounts actually deducted from participants’ accounts by November 14, 2012. **Note:** The participant-level disclosure is only required for defined contribution plans that allow participants to direct their own investments.



# Satisfying top-heavy requirements: It's all in the design

A top-heavy plan is a qualified retirement plan that favors key employees over nonkey employees. There are a number of plan design strategies that can help satisfy top-heavy requirements while providing the employer with more bang for the buck and some that exempt the plan from the top-heavy rules.

## The basics

A defined contribution retirement plan (DC plan) is top heavy if the combined value of key employee plan accounts (whether vested or not) exceeds 60% of the total value of all plan accounts. Determining whether a defined benefit pension plan (DB plan) is top heavy is based on a similar formula using the present value of accrued benefits (i.e., what retirement benefits at normal retirement age are worth today).

If a DC plan is top heavy, minimum contributions (generally up to 3% of a participant's full-year compensation) must be made to all nonkey employees who are employed on the last day of the plan year and who are eligible to receive an allocation from or make contributions to the plan. DC plans must always use a top-heavy (three-year cliff or six-year graded) or faster vesting schedule.

In a top-heavy DB plan, minimum accruals are required (generally, a benefit accrual of 2% for each top-heavy year of service, up to 10 years of service) for all nonkey employees who complete 1,000 hours of service during the year (even if separated from employment). However, depending on the plan's formula, it is possible that actual contributions will not need to be made in a given year for each nonkey employee. If a DB plan is not using a top-heavy vesting schedule (three-year cliff or six-year graded) and it becomes top heavy, it is required to accelerate the vesting schedule.

## Top-heavy 401(k) designs

Elective deferrals made by a key employee are considered employer contributions for top-heavy purposes. If a key employee makes a deferral to a plan that is top heavy,

### Who is a key employee?

Someone who, at any time during the prior plan year, was:

- A more-than-5% owner of the employer (see below),
- An officer with annual compensation greater than \$160,000 in 2011 or \$165,000 in 2012, or
- A more-than-1% owner with annual compensation greater than \$150,000; family attribution rules apply (see below).

### Who is a 5% owner?

An individual who owns more than 5% of the employer.

### What does family attribution mean?

Ownership of a company can be attributed to other family members. For example, an individual is deemed to own any stock (or other ownership interest) that is owned, directly or indirectly, by his or her spouse, parents, children (including those legally adopted), and grandchildren.

and no other employer contributions are made, the plan *must* make a minimum top-heavy contribution on behalf of nonkey employees, even if there are no other employer contributions. (The key employee is not permitted to take back the elective deferral to avoid this situation.)

There are several options for satisfying 401(k) plan top-heavy requirements. Any employer contributions (including matching, profit sharing, qualified, or safe harbor contributions) may be counted toward satisfying the 3% top-heavy contribution. Note, however, that the top-heavy contribution must be based on full-year Section 415 compensation with no exclusions. If a plan's profit sharing contribution formula is based on less than a participant's full-year Section 415 compensation, an additional contribution may be necessary.

A 401(k) plan that is designed as a safe harbor 401(k) plan will be exempt from the top-heavy rules as long as only elective deferrals and contributions that satisfy the safe harbor are allocated in a given year. If the employer makes additional profit sharing contributions or reallocates any preexisting forfeitures, the safe harbor plan would no longer be exempt. In this situation, employer contributions may still count toward satisfying the top-heavy minimum.

## DC + DB designs

An employer with a top-heavy DC plan and

a top-heavy DB plan may satisfy top-heavy requirements by making required allocations to both plans or by:

- Providing the minimum benefit in the DB plan
- Providing the minimum contribution to the DC plan; requires a top-heavy contribution of 5% instead of 3%
- Providing the minimum top-heavy DB plan benefit with a floor offset, where the minimum DB plan benefit is offset by the DC plan benefit
- Providing some top-heavy contributions to both plans, provided the combined benefits are at least equal to the minimum top-heavy contribution for the DB plan

In many cases, the most cost-efficient method is to make an accrual contribution to the DB plan. Why? If the work force is relatively young, then the current value of contributions may be less than an allocation to the DC plan. In addition, accruals to a DB plan are capped at 10 years, and the plan's formula may be in excess of the 2% required. The DB plan's actuary should be consulted.

Generally, top-heavy status is determined as of the last day of the immediately preceding plan year. SIMPLE 401(k) plans and SIMPLE IRAs are exempt from the top-heavy rules.



# RECENT developments

## ▶ Lifetime income

As the number of defined benefit plans decreases and average life expectancies increase in the U.S., there is a growing concern over the ability of participants to generate a lifetime stream of income from 401(k) and other defined contribution plans. Recently, the IRS published two Revenue Rulings with the goal of making it easier for these plans to offer lifetime income retirement benefits.

Rev. Rul. 2012-3 addresses how a defined contribution plan that is not subject to qualified joint and survivor annuity (QJSA) rules may offer a deferred annuity contract without subjecting the entire plan to the QJSA rules. The ruling limits the scope of the QJSA rules to the deferred annuity contract only, which would permit plan participants to purchase deferred annuities with

401(k) assets while still satisfying spousal protection rules.

Rev. Rul. 2012-4 would allow a direct rollover from an employer's defined contribution plan to the same employer's defined benefit plan if the direct rollover funds are converted into an actuarially equivalent immediate annuity.

## ▶ IRS 401(k) compliance check report

In February, the IRS issued its *Section 401(k) Compliance Check Questionnaire — Interim Report*. The original electronic questionnaire was sent to 1,200 sponsors of small, medium, and large 401(k) plans who filed Form 5500 for the 2006, 2007, and 2008 plan years. The questionnaire covered the following topics: demographics, plan participation, employer and employee contributions, top-heavy and ADP/ACP

testing, distributions and plan loans, other plan operations (the effect recent financial conditions had on contribution levels and investment behavior), designated Roth features, the IRS Voluntary Compliance Programs, and plan administration.

According to the IRS, the results will be used to improve 401(k) compliance tools, produce outreach materials, improve voluntary compliance programs, assess whether additional guidance is necessary, and plan upcoming projects and enforcement activities. The interim report, available via a link on the IRS Retirement Plans Community web page ([www.irs.gov/retirement/article/0,,id=253875,00.html](http://www.irs.gov/retirement/article/0,,id=253875,00.html)), also contains answers to some of the questions. A full and final report is expected to be released in December 2012.

The general information in this publication is not intended to be nor should it be treated as tax, legal, or accounting advice. Additional issues could exist that would affect the tax treatment of a specific transaction and, therefore, taxpayers should seek advice from an independent tax advisor based on their particular circumstances before acting on any information presented. This information is not intended to be nor can it be used by any taxpayer for the purpose of avoiding tax penalties.

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