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DOL Releases Interim Final Fee Disclosure Regulations

The DOL has issued interim final regulations requiring service providers to ERISA retirement plans to disclose to plan fiduciaries certain information about the services they provide and the fees they expect to receive for those services. Coupled with the sweeping changes to Form 5500 annual reporting, these new regulations continue the DOL's focus on ensuring detailed disclosures of plan servicing arrangements. The new disclosure requirements are intended to help responsible plan fiduciaries assess the reasonableness of these arrangements, including the compensation to be paid for plan services and the potential conflicts of interest that may affect the service providers' performance.

Background

ERISA requires plan fiduciaries to prudently select and monitor service providers and to act solely in the interest of the plan's participants and beneficiaries. Plan fiduciaries must also ensure that arrangements with their service providers are "reasonable" and that only reasonable compensation is paid for plan services. To do so, plan fiduciaries must have sufficient information to make informed decisions about the services and their providers.

Although ERISA generally prohibits the furnishing of services between a plan and a party in interest to the plan (e.g., a person providing services to the plan), ERISA 408(b)(2) provides an exemption from ERISA's prohibited transaction rules when the contract or arrangement is reasonable, the services are needed for the establishment or operation of the plan, and only reasonable compensation is paid for the services. Currently, a contract or arrangement is considered reasonable if it can be terminated by the plan without penalty on reasonably short notice.

On December 12, 2007, the DOL issued proposed regulations on what constitutes a reasonable arrangement under ERISA Section 408(b)(2) in tandem with a proposed class exemption that would provide relief to plan fiduciaries when service providers fail to meet their disclosure obligations. (See our January 3, 2008 [For Your Information](#).) The DOL has now made significant changes to the 2007 proposed regulations, and released them as [interim final regulations](#).

DOL Interim Final Regulations

The interim final regulations, which are effective July 16, 2011, require covered service providers to provide detailed disclosures of certain direct and indirect compensation received by them, their affiliates and subcontractors. Direct compensation is compensation received directly from the plan. Indirect compensation is

compensation received from any source other than the plan, plan sponsor, covered service provider or its affiliates or subcontractors. Among other things, covered service providers will have to disclose the identities of third parties from whom they directly or indirectly receive fees or compensation in connection with plan services and other potential conflicts of interest.

Covered Plans

The new disclosure regulations apply to both defined contribution and defined benefit pension plans subject to ERISA. For purposes of these regulations, simplified employee pensions (SEPs), simple retirement accounts, IRAs, and non-ERISA plans (e.g., governmental plans, nonelecting church plans) are not covered plans. Importantly, the new disclosure requirements do not apply to health and welfare benefit plans. Rather, the DOL has indicated it will address those plans separately in future guidance.

Covered Service Providers

In general, service providers (not their affiliates or subcontractors) that enter into service contracts or arrangements with covered plans and reasonably expect to receive \$1,000 or more in direct or indirect compensation in connection with a covered service during the term of the applicable contract or arrangement are covered by the new fee disclosure requirements. For this purpose, covered services include –

- direct services provided to the covered plan as an ERISA fiduciary or as a registered investment advisor under the Investment Advisors Act of 1940 or state law
- services provided as a fiduciary to an investment contract, product or entity that holds plan assets and in which the covered plan has a direct equity investment
- certain recordkeeping or brokerage services provided to participant-directed individual account plans (e.g., 401(k) plans) if one or more designated investment alternatives is offered in connection with those services (e.g., through a platform or similar mechanism)
- other services for which the covered service provider, affiliate or subcontractor reasonably expects to receive indirect compensation or compensation paid by a related party, including accounting, actuarial, appraisal, auditing, banking, custodial, insurance investment advisory (for plan or participants), legal, recordkeeping, securities or other investment brokerage, third-party administration, valuation, and/or certain consulting services.

Compensation received by the service provider, affiliate, or subcontractor performing services under the contract or arrangement is counted toward the \$1,000 threshold. Service providers that reasonably expect to receive less than \$1,000 for their services to a plan are exempt from the requirements.

BUCK COMMENT. *Given the breadth of these categories, virtually all entities providing basic or essential plan services could be subject to these new requirements. However, the regulations clarify that furnishing non-fiduciary services to investment vehicles that hold plan assets or rendering services to vehicles that do not hold plan assets will not cause an entity to be a covered service provider.*

Written Disclosure of Services and Compensation

Initial Disclosures. The interim final regulations place the burden of disclosure with respect to plan administration and investments on the covered service provider. Under the new regulations, plan service providers must disclose required information to the plan fiduciary in writing “reasonably in advance” of entering into, extending, or renewing a contract or arrangement for plan services. For existing arrangements, required disclosures must be made by July 16, 2011.

The required disclosures include descriptions of –

- services to be provided (including whether the covered service provider is providing, or reasonably expects to provide, any services as a fiduciary or registered investment advisor to the plan)
- all direct and indirect compensation the service provider, affiliate, or subcontractor reasonably expects to receive in connection with covered services
- all compensation paid among the service provider and its affiliates and subcontractors in connection with covered services if the compensation is paid on a transaction or incentive basis (e.g., commissions) or is charged directly against plan investments
- services for which indirect compensation will be received and the identification of the payer of the indirect compensation
- any compensation that the covered service provider, affiliate or subcontractor reasonably expects to receive in connection with the termination of the contract or arrangement, including the identification of the payer and recipients of such compensation
- the manner in which the service provider will receive fees or compensation (e.g., by billing the plan, by deducting fees from plan accounts, by charging fees against plan investments).

In addition, fiduciaries to plan asset funds (e.g., investment managers) and recordkeepers and brokers who provide one or more investment options to plan participants through a platform or other mechanism have specific disclosure obligations, as discussed below.

Although the regulations do not impose a particular format for the required disclosures, the DOL has requested comments on possibly requiring a summary disclosure statement. The regulations now permit required

disclosures to be contained in a single document or in multiple documents, and necessary information to be incorporated by reference (e.g., a prospectus that contains indirect fee or conflict of interest information).

Investment Disclosures

The disclosure of investment-related compensation is significant because it typically constitutes a large portion of the total expenses incurred by a plan. Because investment-related fees and expenses can dramatically reduce the retirement savings of participants and beneficiaries, responsible plan fiduciaries must carefully assess investment fees and expenses, among other factors, in selecting investment options to be made available in participant-directed individual account plans.

Specific disclosure requirements apply to fiduciaries to investment vehicles that hold plan assets and to recordkeepers and brokers who, through a platform or other mechanism, facilitate the investment in various investment options by individual account plan participants. With respect to each “plan assets” investment vehicle in which the covered plan has a direct equity investment, the organization providing fiduciary services to that vehicle must disclose (1) sales loads, sales charges, deferred sales charges, redemption fees, surrender charges, exchange fees, account fees and purchase fees, (2) a description of annual operating expenses (i.e., the expense ratio), and (3) a description of additional ongoing expenses (i.e., wrap fees, mortality and expense fees).

Recordkeeping Services Disclosures

The interim final regulations require a specific and higher level of disclosure for the costs of recordkeeping services than for other costs to the plan. Thus, if recordkeeping services are provided to a covered plan, the service provider must disclose all direct and indirect compensation attributable to those services that it, its affiliate, or subcontractor reasonably expects to receive – even when no explicit charge for recordkeeping is identified in the service contract. If recordkeeping services are provided, in whole or in part, without explicit compensation or when the compensation is offset or rebated based on other compensation received by the covered service provider, the service provider must furnish a reasonable and good faith estimate of the cost to the plan. The purpose of the estimate is to help responsible plan fiduciaries compare recordkeeping costs among a variety of covered service providers and arrangements. As part of the estimate, the service provider must explain the methodology and assumptions used to create the estimate and provide a detailed description of the services provided to the plan.

Ongoing Disclosure Obligations. In addition to the initial disclosure requirements, the regulations impose ongoing disclosure obligations on covered service providers. A covered service provider must notify the responsible plan fiduciary of any change to the initial disclosure as soon as practicable but generally no later than 60 days after the service provider is informed of the change. A service provider must also disclose, upon request, compensation or other information requested by the responsible plan fiduciary or plan administrator to comply with ERISA reporting and disclosure requirements.

Errors or Omissions

The interim final regulations provide relief for certain inadvertent errors or omissions in disclosures by covered service providers. Despite disclosure errors or omissions, a service arrangement may still be deemed reasonable as long as the covered service provider was acting in good faith and with reasonable diligence, and provides correct information to the plan fiduciary no later than 30 days after the service provider learns of the error or omission.

Prohibited Transaction Class Exemption

Although the new disclosure requirements are imposed on service providers, noncompliance can expose the plan to liability for engaging in a prohibited transaction and the plan fiduciary to liability for failing to satisfy its duty to adequately evaluate the disclosure. The interim final regulations provide a class exemption from ERISA prohibited transaction provisions for plan fiduciaries who enter into contracts without knowing that the service provider has not complied with its disclosure obligations, provided the fiduciaries relied in good faith on the covered service provider, reasonably believed that the service provider satisfied its disclosure obligations, and took prompt remedial action upon discovering the failure to disclose. To be eligible for relief, upon discovering that the covered service provider failed to disclose the required information, the plan fiduciary must request the missing information in writing from the service provider. If the service provider refuses or fails to comply with the written request within 90 days, the plan fiduciary must notify the DOL within 30 days of the service provider's refusal or 90 days after the written request, whichever is earlier. The DOL has provided a [sample notice](#) for this purpose on its website.

To obtain relief, the regulations require the plan fiduciary to determine whether to terminate or continue the service provider's contract or arrangement. Among the factors to be considered are the service provider's failure to disclose, availability, qualifications, and the cost of hiring a replacement.

Effects of Noncompliance

As discussed above, failure to comply with the final regulations could result in an otherwise reasonable arrangement being deemed a prohibited transaction under ERISA Section 406, potentially giving rise to fiduciary liability. Covered service providers that do not comply with the disclosure requirements of the regulations would have to pay excise taxes under Internal Revenue Code Section 4975, which imposes liability on disqualified persons who engage in prohibited transactions with pension plans. Responsible plan fiduciaries that have noncompliant covered service providers and do not qualify for the class exemption will be subject to liability for engaging in prohibited transactions with those service providers.

Effective Date

The regulations are effective on July 16, 2011, and apply to contracts or arrangements between plans and service providers existing on that date and to those entered into on or after that date.

Conclusion

The new regulations' enhanced disclosure requirements will likely reveal costs previously unknown by retirement plan fiduciaries. It is hoped that the increased disclosures will allow fiduciaries to better manage their plans, ultimately resulting in reduced fees for plan sponsors and participants.

Although the regulations will not take effect until next year, plan fiduciaries should begin to consider whether they have adequate processes in place for evaluating service provider arrangements and disclosures. Service providers should ensure that they will have processes in place to identify all compensation that will have to be disclosed.

Buck's consultants would be pleased to discuss the effect of these proposed reporting requirements on your plans and current service relationships.

This FYI is intended to provide general information. It does not offer legal advice or purport to treat all the issues surrounding any one topic.