

New Regulations on Service Provider Fee Disclosure Obligations

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On July 16, 2010, the U.S. Department of Labor (DOL) issued interim final regulations under Section 408(b)(2) requiring that service providers to pension, 401(k) and other retirement plans disclose information to assist plan fiduciaries in assessing the reasonableness of the service providers' compensation and potential conflicts of interest (fee disclosure regulations). The fee disclosure regulations will have an impact on plan fiduciaries and plan sponsors. The regulations will become effective on July 16, 2011.

Background

The Employee Retirement Income Security Act of 1974 (ERISA) Section 408(b)(2) permits plan assets to be used to pay service provider fees, as long as the services are necessary for the operation of the plan and the compensation for the services is reasonable. Service providers that do not comply with the fee disclosure regulations may be subject to the prohibited transaction rules of ERISA and the related excise tax under Section 4975 of the Internal Revenue Code. Plan fiduciaries must monitor compliance and notify the service provider and/or the DOL to be eligible for the prohibited transaction class exemption.

Covered Plans

Pension, 401(k) and other retirement plans (covered plans) are subject to the fee disclosure regulations. The regulations do not apply to welfare benefit plans, Section 457 governmental plans, simplified employee pension (SEP) plans and individual retirement accounts (IRAs).

Covered Service Providers

Service providers that enter into a contract or arrangement with a covered plan, and reasonably expect to receive at least \$1,000 or more in direct or indirect compensation in connection with their services, are subject to the fee disclosure regulations. (Compensation includes amount paid to the affiliates or subcontractors of the service provider.) Covered service providers include the following:

Service providers that are plan fiduciaries, including a fiduciary of an entity that holds plan assets in which the covered plan has a direct equity investment or an investment adviser registered under either the Investment Advisers Act of 1940 or any state law.

Record keepers or brokers to an individual account plan that permits participants or beneficiaries to direct the investment of their accounts if one or more designated investment alternatives will be made available in connection with such recordkeeping or brokerage services, including record keepers that offer a platform for investment options to participant-directed individual account plans.

Persons who provide other services, such as accounting, auditing, actuarial, appraisal, banking, consulting, custodial, insurance, investment advisory (for the plan or for participants), legal, recordkeeping, securities or other investment brokerage, third party

administration or valuation services provided to the covered plan, for which the service provider reasonably expects to receive either “indirect” compensation (i.e., compensation received from any source other than the covered plan, the plan sponsor, the service provider, an affiliate or a subcontractor) or “compensation received among related parties” such as transaction-based compensation or charges against the net value of a plan’s investment (such as 12b-1 fees) as part of a bundled services arrangement.

Considerations for Plan Fiduciaries and Plan Sponsors

Amend Service Provider Contracts

The fee disclosure regulations do not require plan fiduciaries to have a formal written contract with covered service providers. Nevertheless, because the relevant prohibited transaction class exemption requires that responsible plan fiduciaries monitor and notify the covered service provider and/or the DOL of any violations, plan fiduciaries should strongly consider amending existing service provider contracts to delineate disclosure obligations and liability for failure to provide required disclosures.

The following must be disclosed by covered service providers:

A description of the services provided to the plan. The responsible plan fiduciary must determine whether it has enough information to conclude that fees are reasonable. If a particular description lacks sufficient detail, the fiduciary is obligated to request additional information.

A description of direct compensation, which may be in aggregate or by service, and indirect compensation the covered service provider (including its affiliates and subcontractors) reasonably expects to receive.

A description of any compensation that will be “paid among related parties,” which includes bundled service arrangements under which a plan enters into a single contract and pays for multiple services provided by multiple parties. Compensation paid among related parties must be disclosed if it is set on a transaction basis (e.g., commissions, soft dollars, finder’s fees or other fees based on business placed or retained) or charged directly against the covered plan’s investment and reflected in the net value of the investment (e.g., 12b-1 fees). Unlike the Form 5500, Schedule C reporting requirements, which have reduced reporting requirements for certain indirect compensation from bundled service arrangements, the fee disclosure regulations require full disclosure of indirect compensation from bundled service arrangements.

A reasonable estimate of the stand-alone cost of recordkeeping services, including a detailed explanation of the methodology and assumptions, if compensation is for recordkeeping services.

Covered service providers must make initial and ongoing disclosures to a responsible plan fiduciary. Information must be furnished in writing, although there is no set form for disclosure. Disclosures must be made reasonably in advance of the date the arrangement is entered into, extended and renewed. Changes must also be disclosed as soon as practicable, but not later than 60 days from the date the covered service provider is informed of the change. An exception allows a provider 30 days to disclose after the provider begins holding plan assets and becomes a covered service provider.

Develop Procedures to Monitor Disclosures

Responsible plan fiduciaries should take steps to set-up processes to review and confirm that all covered service providers have furnished reports and that the reports contain sufficient detail to enable the plan fiduciaries to determine the reasonableness of the compensation. If a covered service provider fails to comply, responsible plan fiduciaries must notify the provider, notify the DOL and/or consider terminating the arrangement.

Other Fiduciary Obligations

Plan fiduciaries should also be aware that compliance with the fee disclosure regulations does not negate ongoing fiduciary obligations with respect to hiring, retaining and monitoring service providers. The fee disclosure regulation requirements are independent of the general fiduciary obligations set forth in ERISA, including the duties of loyalty and prudence, which obligate plan fiduciaries to obtain sufficient information to make informed decisions in retaining and monitoring service providers. These general fiduciary duties apply prior to the effective date of the fee disclosure regulations and will continue to apply once the fee disclosure regulations are in effect.

DOL Comment Period

Because the fee disclosure regulations contain a number of significant changes from the proposed regulations, the DOL published them as interim final regulations in order to permit additional comments. Interested persons can comment to the DOL until Aug. 30, 2010.

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