

NEW DEPARTMENT OF LABOR REGULATIONS REQUIRE DISCLOSURE BY PLAN SERVICE PROVIDERS

Introduction

On July 16, 2010, the Department of Labor (“DOL”) issued an interim final rule establishing the requirements that retirement plan service providers must meet in disclosing the compensation they receive for providing services. By the time these regulations are effective, on July 16, 2011, plan fiduciaries should have received certain required information from the service providers who are covered by the regulation (“covered service providers”). After the effective date of the regulations, the disclosures must be made in advance of entering into a contract for services. Failure to receive this information on a timely basis could result in a violation of ERISA and the Internal Revenue Code’s prohibited transaction rules, and the fiduciary could be exposed to personal liability.

Background

Under ERISA, a retirement plan fiduciary is required to ensure that an agreement between a retirement plan and a service provider is “reasonable.” The DOL has been concerned for some time that the increased complexity in the way that services are provided to plans makes it difficult for fiduciaries to know what they are paying for those services. Consequently, in 2007 the DOL published a proposed rule setting out the cost information that fiduciaries are required to receive from service providers to help them select and monitor service providers and to determine whether the agreement with the service provider is reasonable. After reviewing a large volume of comments from the retirement plan community, the DOL issued this interim final rule. Under this new regulation, no contract or arrangement for services between a covered plan and a covered service provider is “reasonable” unless certain disclosures are made to the plan fiduciary.

Those plan administrators who file Schedule C of the Form 5500 may be aware that for the 2009 filing year additional information was required to be included addressing service provider compensation. The DOL has said that the new regulation is intended to complement, but is not identical to, the Schedule C requirements.

Covered Plans

The new regulations cover most pension plans that are subject to ERISA. However, they do not cover IRAs, “simplified employee pensions”, and “simple retirement accounts.” They also do not apply to welfare benefit plans. The DOL has said that it will develop other rules to address welfare benefit plans in the future.

Covered Service Providers

The regulations do not require all service providers to provide disclosures. Instead, the DOL has identified three categories of service providers from which it believes disclosure would be the most helpful. Even if a service provider falls within one of the categories described below, it does not need to meet these rules unless it reasonably expects to receive \$1000 or more in compensation for providing the service.

- 1) Services provided directly to the plan as a fiduciary or registered investment advisor
 - A. Services provided directly to the plan as a fiduciary as defined in ERISA
 - B. Services provided as a fiduciary to certain types of plan investments (not generally applicable to 403(b) plans)
 - C. Services provided directly to a covered plan as an investment advisor registered under federal or state law.
- 2) Recordkeeping or brokerage services to an individual account plan (such as a 403(b) or 401(k) plan) if the plan allows participants to direct their investments to one or more designated investment alternatives in connection with the recordkeeping or brokerage services.
- 3) Certain other services paid for by “indirect compensation” or “compensation paid among related parties” (both defined below), including accounting, auditing, actuarial, banking, consulting, custodial, insurance, investment advisory, legal, or third party administration provided to the covered plan.

Definition of Compensation

- 1) Direct compensation is compensation received directly from the covered plan, and includes all amounts that the service provider (or an affiliate or a subcontractor of the service provider) reasonably expects to receive for providing the services listed above.
- 2) Indirect compensation is compensation received from any source other than the covered plan, the plan sponsor, the service provider, or an affiliate or a subcontractor of the service provider, and includes the amount that the service provider (or an affiliate or a subcontractor of the service provider) expects to receive for providing the services listed above.
- 3) Compensation paid among related parties is compensation paid among the service provider, an affiliate or subcontractor in connection with the services, if it is paid based on a transaction (like a commission) or is charged against the plan’s investments and is reflected in the net asset value of the investment.
- 4) Compensation for termination of a contract or arrangement is any compensation that the service provider (or an affiliate or a subcontractor of the service provider) reasonably expects to receive in connection with the termination of the contract or arrangement.

Initial Disclosure Requirements

Generally, the service provider must provide certain information to a responsible plan fiduciary reasonably in advance of the date that the contract or arrangement is entered into, extended or renewed (certain exceptions apply.) The disclosure must contain the following information:

- 1) A description of the services to be provided to the plan. The DOL recognized that the level of detail required for a particular service would vary depending on the situation. However, it also said that the plan fiduciary must determine if it has enough information to make a judgment as to whether the service agreement is reasonable. If it does not think it has enough information to make that determination, the fiduciary must request more information.
- 2) Where applicable, a statement that the service provider will provide, or reasonably expects to provide, services to the plan as a fiduciary or as an investment advisor under federal or state law.
- 3) As defined above, the direct or indirect compensation paid to the service provider, an affiliate or subcontractor, the compensation paid among related parties, or the compensation for the termination of a contract or an arrangement. Compensation may be expressed as an amount, formula percentage of the plan's assets, or a per capita charge for each participant or beneficiary. If the compensation cannot be reasonably expressed in those terms, the service provider can use any other reasonable method.
- 4) There is a special rule for recordkeeping services which is designed to address a "bundled provider" of recordkeeping services. In a bundled arrangement, recordkeeping services are included as part of a number of services and are not charged for separately. This is a very common arrangement in 403(b) plans. If a service provider reasonably expects recordkeeping to be provided without explicit compensation, or if the compensation for recordkeeping is offset or rebated based on other compensation received by the service provider, the provider must provide a reasonable good faith estimate to the plan of the cost of the recordkeeping services. The service provider will include an explanation of the methodology and assumptions used to prepare the estimate and an explanation of the recordkeeping services that will be provided.
- 5) When a service provider makes available recordkeeping or brokerage services to an individual account plan (see Covered Service Providers, paragraph 2, above), the service provider is responsible for disclosing certain information about the designated investment alternatives. That information includes a description of, a) the compensation that will be charged against the amount invested in connection with the acquisition, sale, transfer of or withdrawal from the investment alternative, b) the investment's annual operating

expenses (e.g., the expense ratio), and c) a description of any ongoing expenses, such as wrap fees or mortality and expense fees.

Fiduciary Relief

As noted above, a plan fiduciary can be found to have violated the prohibited transaction rules of ERISA and the Internal Revenue Code if it does not receive the required information from the service provider on a timely basis. Because the DOL recognized that there may be some circumstances where the requirements of the regulation will not be met that are not the responsibilities of the plan fiduciary, the regulations contain an exemption that provides them with limited relief. The plan fiduciary will not be liable for a violation of the prohibited transaction rules if the following conditions are met:

- 1) The plan fiduciary did not know the that service provider failed or would fail to make the required disclosures and reasonably believed that the service provider disclosed the required information
- 2) The plan fiduciary requests in writing that the service provider furnish the information
- 3) If the service provider fails to comply with the request within 90 days, the fiduciary notifies the DOL. The DOL has posted a sample notice on its website.
- 4) Following the discovery of the service provider's failure to provide information, the plan fiduciary must determine whether to terminate or continue the contract or arrangement, considering the relevant circumstance.

Next Steps for Plan Fiduciaries

Plan fiduciaries should use the time between now and the effective date of the new regulations to review their retirement plans and examine the service contracts and arrangements they have in place at this time. Plans should enhance their fiduciary procedures to implement a system for ensuring that they receive all required disclosure and then for reviewing the disclosures that are received. Keep in mind that it is not enough just to receive the disclosure material, but the information must be analyzed to help determine whether a service provider contract or arrangement is "reasonable." Finally, fiduciaries should implement procedures for following the steps to obtain relief from fiduciary liability in the event a service provider does not supply the necessary information.

If you have any questions about this newsletter, please contact either Evan Giller or Monica Calhoun.

