



Retirement Plan Update

Service Provider Fee Disclosure: Another Step toward Fee Transparency

On July 16, 2010, the Department of Labor (“DOL”) published interim final regulations under ERISA §408(b)(2) 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.

The purpose of these new regulations is to ensure that pension plan fiduciaries have sufficient information to determine whether the terms of service arrangements are reasonable, including the compensation to be paid for plan services and any potential conflicts of interest that may affect the provider’s performance. *Failure to comply with these new rules can expose both the plan fiduciary and service provider to liability.*

This Retirement Update provides the key highlights of the interim final regulations, identifying what plan sponsors may wish to consider before the effective date.

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

The regulations are part 2 of the DOL’s 3-prong fee project. Part 1 was a revised Form 5500, Schedule C (required by “large plans”) requiring reporting of extensive information on direct and indirect fees paid by the plan. Part 3, expected to be issued before year end, will address participant-level fee disclosures.

Background

Under ERISA, any person providing services to a plan or its participants will become a “party in interest” to the plan by reason of providing these services. ERISA §406(a), in turn, prohibits a party in interest from providing services to the plan. The solution to this problem lies in ERISA §408(b)(2), which 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.

If a service arrangement does not comply with the conditions under §408(b)(2), the plan fiduciary approving the service arrangement will be deemed to have caused the plan to engage in a prohibited transaction under ERISA §406 - a violation of his or her fiduciary duties - and be potentially liable to the plan participants “to restore any losses or any smaller gains than expected.” A failure may also leave plan fiduciaries more exposed to litigation alleging that plan expenses are unreasonable with personal liability again for any losses the plan incurs or any gains that the plan did not receive. Covered service providers that fail to comply may be subject to the applicable 15% prohibited transaction excise taxes under IRC §4975.

Until now, there has been only limited guidance as to what constitutes a reasonable contract or arrangement. In addition, plan fiduciaries had few tools at their disposal to get straightforward fee information from their service providers in order to make a determination of reasonableness. The new regulations have changed this. They require service providers covered by the rule to provide detailed disclosures of certain direct and indirect compensation received by them, their affiliates and/or their subcontractors.

Note, however, that the new regulations address only what constitutes a reasonable contract or arrangement under ERISA §408(b)(2). As such, the other provisions of the existing regulations continue to apply with respect to the standards for determining when a service is “necessary,” what is “reasonable compensation,” and special considerations for arrangements that involve conflicts of interest for plan fiduciaries.

The new disclosure requirements 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, tribal government plans, and nonelecting church plans) are not covered plans. Importantly, the new disclosure requirements do not apply to health and welfare plans.

Covered Service Providers

A service provider is a “covered service provider” subject to the new disclosure requirements if it reasonably expects to receive at least \$1,000 in compensation, directly or indirectly, under a contract or arrangement for any of the following services:

- Fiduciary services or services provided to the plan as a registered investment adviser - such as from some investment consultants.
- Recordkeeping or brokerage services to a participant-directed individual account plan where the investment options are made available through a platform offered in connection with such recordkeeping or brokerage services - such as from insurance companies, mutual fund companies, or trust companies.
- Other specified services - including, for example, accounting, auditing, actuarial, investment policy development and related consulting, legal, recordkeeping, or valuation services - for which indirect compensation is expected to be received - such as accountants, actuaries, administrators, and attorneys.

Required Disclosures

Under the ERISA §408(b)(2) interim final regulation, a plan will not be able to enter into a relationship with a covered service provider unless the following information is provided in writing to a responsible plan fiduciary at the time that the service provider is retained.

- Services: A description of the services to be provided.
- Status: A statement, if applicable, that the services will be provided as a fiduciary and/or as a registered investment adviser.
- Compensation: Disclosure of all direct and indirect compensation the service provider, affiliate, or subcontractor expects to receive; 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; compensation for termination of the arrangement.
- Manner of Receipt: A description of how compensation will be received (e.g., billed to the plan or deducted directly from plan accounts).

Specific investment fiduciaries (e.g., investment managers), in addition to recordkeepers, and brokers who provide one or more investment options to plan participants through a platform or other mechanism, have additional disclosure obligations with respect to investments for which they provide services.

Regulations require a specific and higher level of disclosure for the costs of recordkeeping services than for other costs to the plan. The recordkeeping service provider must disclose all direct and indirect compensation attributable to those services even when no explicit charge for recordkeeping is identified in the service contract.

In general, covered service providers must make the required disclosures before entering into, renewing, or extending a contract or arrangement. If the information changes, then the covered service provider generally must inform the plan fiduciary as soon as practicable, but no later than 60 days from the date of a change.

Action to Take Now

Prior to July 2011, plan fiduciaries should look for assistance in determining those service providers required to provide the new disclosures and begin to consider whether they, as fiduciaries, have adequate processes in place for evaluating the arrangements and disclosures. Moreover, fiduciaries should be prepared to document the review as part of their fiduciary “due diligence” oversight of plan expenses.

Should you have any questions regarding this *Retirement Plan Update*, contact our consulting team at 619-696-7284.