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Disclosure of Plan Service Provider Fees

The Department of Labor (DOL) recently published Interim Final Rules (Interim Rules) addressing fee disclosure requirements for retirement plan service providers. The Interim Rules define what fee disclosures must be included in a service provider contract or arrangement for it to constitute a “reasonable” contract or arrangement with a retirement plan. Absent compliance with the final rules, a prohibited transaction under ERISA will occur.

The Interim Rules apply only to retirement plans, such as defined benefit pension, profit sharing, 401(k), and 403(b) plans. The DOL has indicated, however, that guidance for welfare plans will be issued in the near future. The Interim Rules do not, however, apply to simplified employee pension plans, SIMPLE plans, or IRAs, nor do they apply to non-ERISA plans such as a non-electing church plans or government plans.

The Interim Rules become effective on July 16, 2011, and will apply to all contracts or arrangements with “covered” service providers entered into on or after that date. Contracts or arrangements entered into prior to July 16, 2011, will have to be brought into compliance by that date; parties cannot wait until the next renewal date to comply.

What is a Covered Service Provider?

A covered service provider (CSP) is a service provider that enters into a contract or arrangement with a plan and reasonably expects to earn \$1,000 or more in direct or indirect compensation in connection with providing those services, regardless of whether those services are to be performed by the CSP, an affiliate or a subcontractor.

A service provider will be a CSP, if it provides any of the following:

- services as a fiduciary to the plan;
- services as a fiduciary to an investment contract, product or entity that holds plan assets;
- services provided to the plan as an investment advisor under the Investment Advisors Act of 1940 or any state law;
- record keeping or brokerage services provided to an individual account plan that permits participants to direct the investments in their accounts; and
- accounting, auditing, actuarial, appraisal, banking, consulting, custodial, insurance, investment advisory, legal, recordkeeping, securities or other investment brokerage, third party administration or valuation services for which the CSP, an affiliate or subcontractor expects to receive (i) indirect compensation, (ii) compensation that will be paid among them on a transaction basis (for example, commissions, soft dollars, finder’s fees or other similar compensation based on business placed or retained) or (iii) compensation charged directly against the plan’s investments.

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Disclosure Requirements

Though the Interim Rules require that these disclosures be in writing, they do not require a written contract between the CSP and the plan or plan sponsor. Nevertheless, it is likely that these written disclosures will be found in a service agreement of some sort. The required disclosures are:

- A description of the services to be provided;
- If applicable, a statement that the CSP intends to provide services as a fiduciary;
- If applicable, a statement that the CSP intends to provide services as an investment advisor under either the Investment Advisers Act of 1940 or any state law;
- A description of all compensation received directly from the plan;
- A description of all indirect compensation;
- A description of any compensation that will be paid among the CSP, an affiliate or a subcontractor in connection with the services, if paid on a transaction basis or is charged directly to the plan's investments and reduces their net value;
- A description of any compensation to be paid in connection with the termination of the contract or arrangement, and how any prepaid amounts will be calculated or refunded upon termination;
- If recordkeeping services are provided, a description of all direct and indirect compensation for such services. If the CSP reasonably expects that recordkeeping services will be provided, in part or in whole, without explicit compensation (that is, where recordkeeping fees are bundled as part of a package), or when compensation for such services may be offset or rebated based on other compensation to be received, a reasonable good faith estimate of the recordkeeping service fees must be provided, including an explanation of the methodology and assumptions used to estimate the fees and a detailed description of the recordkeeping services being provided;
- A description of the manner in which the compensation will be received – for example, billed to the plan, deducted directly from the plan, or billed to the sponsor; and
- If the CSP is a fiduciary to an investment contract, product or entity that holds plan assets, for each such contract, product or entity in which the plan has a direct investment, a description of (i) any compensation that will be charged directly against the amount invested in connection with the acquisition, sale, transfer of or withdrawal from the investment contract, product or entity (for example, sales loads, redemption fees and surrender charges), (ii) annual operating expenses, and (iii) any ongoing expenses in addition to the annual operating expenses (for example, wrap fees or mortality and

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expense fees). These disclosure obligations may be met by providing the current disclosure materials of the designated investment alternative provided that (a) the issuer is not an affiliate of the CSP, (b) the disclosure materials are regulated by a state or federal agency, and (c) the CSP does not know that the materials are either incomplete or inaccurate.

Timing of the Disclosure

General Timing Rules — The CSP must disclose the required information to a “responsible plan fiduciary” – meaning, a fiduciary with authority to cause the plan to enter into, extend or renew the contract or arrangement – reasonably in advance of the date on which the contract must be entered into, extended or renewed, except that:

- if an investment contract, product or entity is deemed not to hold plan assets and it later is determined that it does, this must be disclosed no later than 30 days from the date the CSP knows of this, and
- any investment alternative that is not designated at the time the contract or arrangement is entered into must be disclosed as soon as practicable, but no later than the date the investment alternative is designated by the responsible plan fiduciary.

Change in Required Information — Any change in the information required to be disclosed under the Interim Rules must be disclosed as soon as practicable, but not later than 60 days from the date on which the CSP is informed of the change, unless such disclosure is precluded on account of extraordinary circumstances, in which case it must be disclosed as soon as practicable considering the circumstances.

Reporting and Disclosure — Upon request, the CSP must provide any other information relating to compensation received in connection with the contract or arrangement that is required for the plan administrator to comply with certain ERISA reporting and disclosure requirements, including but not limited to Form 5500 annual reports. This information must be provided within 30 days of the date of the request.

Disclosure Errors — No contract or arrangement will fail to be reasonable solely because the CSP, acting in good faith and with reasonable diligence, makes an error or omission, provided that the CSP disclose the correct information no later than 30 days from the date the error or omission is known to the CSP.

Exemption for Responsible Plan Administrator

Under the proposed regulations, the DOL had issued a proposed class exception that would allow plan fiduciaries to avoid liability for a prohibited transactions, if the plan fiduciary: (i) reasonably believed the CSP had made all the proper disclosures, (ii) upon discovering a failure

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to disclose, requested in writing that the CSP provide the required information, (iii) the CSP fails to comply with the information request within 90 days, and (iv) the plan fiduciary notifies the DOL of the CSP's failure. The proposed exemption has been incorporated into the Interim Rules.

No Preemption of State Law

Nothing in the Interim Rules preempts state laws governing disclosures by service-providing parties, except to the extent that the application of the state law would prevent the application of the Interim Rules.

Internal Revenue Code

The Internal Revenue Code contains prohibited transaction rules that are similar to ERISA's prohibited transaction rules. The Interim Rules apply equally to the Internal Revenue Code's prohibited transaction rules.

Action Steps

An employer that sponsors a retirement plan needs to understand the Interim Rules, gather and catalogue all CSP contracts and arrangements for its retirement plan(s) that may be subject to the Interim Rules, and carefully review those arrangement to ensure that they contain the required disclosures, and, if not, they will need to be revised to ensure that the disclosures have been timely made.

A CSP needs to identify all of its compensation arrangements that need to be disclosed, including an assessment of payment arrangements involving affiliates and subcontractors. A CSP may need to consider whether any of its arrangements need to be revised or re-negotiated to comply with the Interim Rules. A CSP also needs to review its standard contract templates to ensure that they contain the disclosures required by the Interim Rules.

If you have any questions about the Interim Rules and how they apply to your retirement plan arrangements (if you are an employer with a retirement plan) or how they apply to your service contracts (if you are a CSP), or if you have questions about any other employee benefit issues, please contact any of the Honigman attorneys listed in this Alert.

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