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Final Rule on Disclosure of Plan Service Provider Fees to Plan Fiduciaries

Under ERISA, an arrangement between a plan and a plan service provider must provide for no more than reasonable compensation to the service provider. If an arrangement fails to meet this requirement, it may be a prohibited transaction under ERISA, which is a bad result for the service provider and the plan's fiduciaries. The U.S. Department of Labor recently issued final rules on fee disclosures that must be made by plan service providers to plan fiduciaries in order to avoid a "prohibited transaction" under ERISA. This Benefits Alert summarizes these service provider disclosure rules.

Compliance Deadline

The service provider fee disclosure rules are effective **July 1, 2012**. Your plan's service provider contracts or similar arrangements entered into prior to that date must be brought into compliance by the July 1 effective date; you cannot wait until the next contract renewal date to comply. For service provider contracts or arrangements entered into or renewed after July 1, the information required under the rules must be provided reasonably in advance of the date the contract or arrangement is entered into or renewed.

Plans Covered

The service provider fee disclosure rules apply to ERISA defined benefit and defined contribution retirement plans, such as traditional pension plans and 401(k) plans. The rules **do not apply** to:

- Simplified employee pension plans (SEPs);
- SIMPLE retirement accounts;
- IRAs; and
- "Frozen" 403(b) annuity contracts and custodial accounts, *i.e.*, those issued prior to January 1, 2009, where (i) the sponsoring employer has stopped making contributions, (ii) the individual owners of the contracts or accounts have rights or benefits enforceable against the issuer or custodian without employer involvement and (iii) the individual owners are fully vested.

The rules do not apply to welfare benefit plans, but the Department of Labor has indicated that it intends to publish proposed service provider disclosure requirements for welfare plans in the near future.

Covered Service Providers

Service providers covered under the rules are service providers who enter into a contract or arrangement with a plan and reasonably expect to earn \$1,000 or more in direct or indirect compensation in connection with providing those services, whether the services are to be performed by the service provider itself, or an affiliate or subcontractor. Affiliates and subcontractors of a service provider, however, are not themselves covered service providers.

Covered service providers are those that provide the following kinds of services:

- Services as a fiduciary to the plan or as a fiduciary to an investment contract, product or entity that holds plan assets.
- Services provided as an investment advisor under the Investment Advisors Act of 1940 or any state law.
- Recordkeeping or brokerage services to an individual account plan that permits participants to direct the investments in their accounts.
- Accounting, auditing, actuarial, appraisal, banking, consulting, custodial, insurance, investment advisory, legal, recordkeeping, securities brokerage, third party administration, or valuation services provided to a plan.

What Must Be Disclosed

A covered service provider must disclose the following information in its contract or other written arrangement with a plan:

- The services to be provided and all direct or indirect compensation to be received by the service provider, its affiliates and/or subcontractors. "Compensation" includes money or any other thing of monetary value. "Direct compensation" is compensation received directly from the plan. "Indirect compensation" is compensation received from any source other than the plan, the service provider, an affiliate or a subcontractor. Compensation may be expressed as a formula, asset charge, or per capita charge so long as the description permits a plan fiduciary to evaluate the reasonableness of the compensation. A reasonable and good faith estimate of the compensation is allowed if the compensation cannot otherwise be described, but the service provider must disclose the methods and assumptions used in making the estimate.
- Any arrangement between the payer and the service provider if indirect compensation is paid, including the source of the payment and the services for which the payment was made. This is intended to better disclose to a plan fiduciary any potential conflicts-of-interest relating to the service provider.
- The allocation of compensation among the related parties – *i.e.*, the service provider, its affiliates and/or subcontractors – where the compensation is the result of charges made against plan investments or are set on a transaction basis.

- The compensation the service provider, an affiliate and/or subcontractor reasonably expects upon termination of the contract or arrangement.
- The manner in which compensation will be received – *i.e.*, direct billing, deduction from plan accounts, charges against plan investments, *etc.*
- Whether the service provider is providing recordkeeping services and the compensation attributable to such services, even if there is no identifiable charge for recordkeeping.
- An investment’s annual operating expenses and any other ongoing operating expenses, including sales loads, redemption fees, *etc.* For individually directed account plans, such as a 401(k) plan, the disclosure must include total annual operating expenses.
- For a designated investment alternative, any other information or data about the investment alternative that is within the control of, or is reasonably available to, the service provider that the plan administrator would need to comply with the Department of Labor regulations regarding participant-level disclosures. For record keeper and broker service providers, these disclosure obligations can be met by providing materials from the investment issuer so long as (i) the issuer is not an affiliate, (ii) the issuer is a registered investment company or state-licensed insurer, and (iii) the service provider, acting in good faith, does not know if the materials are incomplete or inaccurate and states that it makes no representation as to the completeness or accuracy of the materials provided.
- If applicable, whether the service provider, an affiliate and/or any subcontractor will, or reasonably expects to, provide services as an ERISA fiduciary or as a registered investment advisor.

The Department of Labor indicates that it encourages covered service providers to offer plan fiduciaries a guide or summary to assist them in identifying all the relevant disclosures in the contract or other written documentation of the arrangement and a sample guide is included as an appendix to the rules. Currently, this is not a requirement, but the Department of Labor has indicated that it intends to propose regulations that would make this a requirement.

Other Disclosure Deadlines

- *New Investment Option.* Information on new plan investment options must be disclosed before the options become available under the plan, but if a non-plan asset investment vehicle comes to hold plan assets, the provider must disclose this as soon as feasible but not later than 30 days from the date it has knowledge of this change, or if an investment is not a designated investment alternative at the time an arrangement with a participant-directed plan is entered into, the recordkeeper or broker must provide the required investment-related information as soon as practicable after it is so designated by the plan fiduciary.

- *Changes in Investment-Related Information.* Changes in investment-related information must be made at least annually, and changes to other required information must be made as soon as feasible, but no later than 60 days after the covered service provider acquires knowledge of the change.
- *Reporting and Disclosure.* A covered service provider must report information to plan fiduciaries needed for the fiduciaries to comply with ERISA's reporting and disclosure obligations reasonably in advance of the date upon which the fiduciary says the information is needed.
- *Disclosure Errors.* A covered service provider may correct disclosure errors or omissions within 30 days, if the error or omission was made in good faith and with reasonable diligence.

Protection For Plan Fiduciaries

The rules provide a class exemption from ERISA prohibited transaction liability for plan fiduciaries where a covered service provider fails to meet the disclosure requirements. The exemption provides protection where the plan fiduciary: (i) did not know that the service provider failed to make the required disclosure and reasonably believed that all appropriate disclosures had been made, (ii) upon discovery of the failure, requests in writing that the service provider provides the missing disclosure or corrects the inaccurate disclosure, (iii) notifies the Department of Labor if the service provider does not comply with the written request within 90 days, and (iv) makes a determination as to whether the failure requires termination of the contract or arrangement. **If the information relates to future services and is not disclosed promptly after the 90-day period, the plan fiduciary must terminate the contract or arrangement as quickly as is feasible.**

Action Steps

If your company sponsors a defined benefit pension plan or a defined contribution retirement plan, such as a 401(k) plan:

- You must determine who is a plan fiduciary for each plan and identify any covered service providers for each plan.
- Each plan fiduciary should familiarize him or herself with the service provider fee disclosure rules in order to know what category each covered service provider falls into, and determine what disclosures are required of each covered service provider.
- If there are already service provider contracts in place, contact each covered service provider to address how those agreements may need to be modified to meet these new fee disclosure rules.

- If the contract is going to be renewed or a new contract with a new covered service provider is contemplated, it will be necessary to see the proposed agreements long enough before the compliance deadline of July 1, 2012, to allow enough time for the plan fiduciary to review the agreement and discuss any disclosure issues it finds with the covered service provider.
- The plan fiduciary will need to satisfy him or herself that all necessary disclosures have been made, that they are sufficiently detailed and that any other appropriate information is provided.
- Finally, the plan fiduciary must satisfy him or herself that the services provided are essential for the maintenance and operation of the plan and that the overall compensation for the services to be provided are reasonable.

If you have any questions about these disclosures, any contract arrangements with specific covered service providers, or any other issues relating to providing employee benefits, please contact any of the Honigman attorneys listed on this Benefits Alert.