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Employee Benefits Alert

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Department of Labor Issues Final ERISA Fee Disclosure Rules

Earlier this year, the Department of Labor ("DOL") released final regulations under ERISA section 408(b)(2) setting forth the fee disclosure requirements that apply to service providers of ERISA plans. These regulations, which require certain service providers to give extensive disclosures to ERISA plan fiduciaries **effective July 1, 2012**, modify the interim regulations previously released by the DOL in 2010. In this alert, we will lay out the basics of the service provider disclosure requirements effective July 1, 2012, as well as how plan sponsors should utilize these disclosures.

Background

ERISA section 408(b)(2), which provides an exemption from ERISA's prohibited transaction rules, requires arrangements between ERISA plans (generally retirement plans, pension plans and welfare benefit plans) and service providers to be "reasonable", and for service providers to receive no more than reasonable compensation. Previously, the Department of Labor had not given much detail as to what makes a service contract reasonable. However, under the new regulations, beginning July 1, 2012, for contracts between retirement and pension plans and their service providers to be reasonable, the providers must disclose certain information about their compensation to plan fiduciaries in writing before the fiduciaries enter into, renew, or extend their plans' service contracts. The purpose of the rule is to give plan fiduciaries adequate information to make informed decisions about the compensation being paid to service providers, and the services actually being provided to the plan in return for such compensation. Certain frozen annuity contracts and custodial accounts established under Internal Revenue Code section 403(b) are not subject to the new regulations. In addition, these new rules do not currently apply to employee welfare plans governed by ERISA.

Covered Service Providers

The regulations apply specifically to "covered service providers". A covered service provider for purposes of the regulation is a service provider that enters into a contract with the plan and reasonably expects to receive $1,000 or more (a) for its services as a fiduciary, registered investment advisor, recordkeeper or broker; or (b) for other services, such as auditing, accounting and legal services, for which the provider receives indirect compensation.

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Content and Timing of Disclosure

The regulations require a covered service provider to furnish the applicable fiduciary with a written description of the following, reasonably in advance of the date the service contract is entered into, extended or renewed:

- The services to be provided;
- If applicable, a statement that the covered service provider, its affiliate or subcontractor will provide services as a fiduciary or registered investment advisor;
- All "direct compensation" that the covered service provider, its affiliate or subcontractor expects to receive in connection with its services to the plan. Direct compensation is compensation paid either directly from the plan, or directly from the plan sponsor which is then reimbursed by the plan;
- All "indirect compensation" that the covered service provider, its affiliate or subcontractor reasonably expects to receive in connection with its services to the plan, along with a description of the services for which the indirect compensation will be received, the payer of the compensation, and a description of the arrangement between the indirect compensation's payer and recipient. Indirect compensation is compensation received by a third party (other than the plan sponsor) who deals with the plan;
- Any compensation that will be paid among the covered service provider or a related party in connection with services to the plan that is transaction based (like commissions) or charged directly against the plan's investment and reflected in the investment's net value (e.g., 12b-1 fees). This must be separately disclosed, even if it is also disclosed as direct or indirect compensation;
- Any compensation that the covered service provider expects to receive when the arrangement terminates, and how any prepaid amounts will be calculated and refunded upon such termination;
- All compensation expected to be received in connection with recordkeeping services to the plan;
- The manner in which all compensation will be received.

Additional disclosures are required if the covered service provider provides fiduciary services to an investment contract, product or entity that holds plan assets and in which the plan has a direct equity investment, or if the covered service provider provides recordkeeping or brokerage services to a plan offering designated investment alternatives. A designated investment alternative is an investment alternative offered by a plan into which participants may direct the investment of their individual accounts.

A Plan Sponsor's Approach to the Disclosure Requirements

Although the regulations impose the disclosure obligations on covered service providers, the plan sponsor, as a fiduciary receiving the disclosed information, should review all of the information provided by such service providers to ensure that all compensation paid is reasonable. This is consistent with the plan sponsor's fiduciary duties under ERISA section 404(a), and it seems likely that the receipt of this detailed information by a fiduciary will result in that fiduciary being held to a higher standard in evaluating the reasonableness of the relationship with the service provider. Following is a list of action steps plan sponsors should consider taking:

1. Determine who are the plan's covered service providers. This list will generally include the plan recordkeeper, trustee, broker and investment advisor.
2. Make sure the disclosures are timely provided by all covered service providers. As noted above, **July 1, 2012** is the disclosure deadline for existing service arrangements. For new arrangements, the disclosures must be provided by the covered service provider reasonably in advance of the time at which the arrangement is entered into. While "reasonably in advance" is not defined in the final regulations, it is prudent for the disclosures to be provided to the plan fiduciaries within a period of time that allows the plan fiduciaries to evaluate the information to ensure that the arrangement is reasonable. Finally, if the service provider becomes aware of a change in any information in the disclosures, the service provider must notify the plan fiduciary of such change within 60 days of learning of the change.
3. Make sure the disclosures contain the required information. It is important that the plan sponsor understands all the components of the fees paid to each covered service provider. The plan sponsor should also compare the actual fees as reported in the disclosures with the fees contemplated in the service agreement between the plan and the covered service provider. If the disclosures are confusing, or seem deficient, the plan sponsor should contact the covered service provider with questions or request clarification. Of course, you may also contact your attorney at Shipman & Goodwin with any questions about what has been disclosed or for further assistance.
4. Consider benchmarking the disclosed fees against those paid by similar plans for similar services. Although the regulations do not require it, benchmarking is a way for the plan sponsor to ascertain whether the fees the plan is charged for services are significantly higher (or lower) than those paid by similarly situated plans. A plan sponsor can obtain this comparison in a number of ways: by doing a request for proposal ("RFP") to other service providers, by retaining an investment consultant to do the research, or by engaging a company that offers benchmarking services.

5. Engage in the ongoing best practice of regular plan meetings. The plan sponsor should regularly hold meetings with those persons or committees responsible for plan administration, to monitor and discuss the performance of the plan's investment options and the reasonableness of the plan's fees.

Disclosures to Participants

There are additional regulations, issued by the DOL under ERISA section 404(a), that require *plan sponsors* to disclose to *participants* fees and other information about plan investments. Initial disclosures under those regulations, which flow from the disclosures made by a plan's service providers, must be provided to participants by **August 30, 2012**. We expect to provide a subsequent alert on these regulations in the near future.

For More Information

For more information about the disclosure requirements imposed on service providers (or on the disclosure requirements from plan sponsors to plan participants), please contact Kelly Smith Hathorn or any other member of the practice group:

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