Pension Plan Fix-It Handbook

Employee Benefits Series | THOMPSON | September 2010 | Vol. 17, No. 12

DOL's Interim Final Rule Requires Detailed Fee Disclosure

By Mary B. Andersen

Plan fiduciaries will be able to obtain the information necessary to make informed decisions regarding services rendered to and expenses paid from the plan. That's the goal of the interim final rule relating to fee disclosure that the Department of Labor's (DOL) Employee Benefits Security Administration (EBSA) issued on July 16.

The regulations — Reasonable Contract or Arrangement Under Section 408(b)(2) — Fee Disclosure — are effective July 16, 2011. They apply to defined contribution and defined benefit plans. They don't apply to health and welfare plans, which will be subject to separate provisions to be issued in the future. Interim regulations can be relied upon as if they were final; however the interim regulations are subject to change. Comments on the interim regulations can be made until Aug. 30, 2010.

What Does it All Mean?

If you are an employer that sponsors a covered plan that receives the services described in the regulations from a covered service provider, then you should be receiving certain disclosures to avoid a prohibited transaction. If you don't receive the disclosures, you have to ask for them; if you still don't receive the disclosures, you must notify the DOL. The glaring question is: How do you know you have received everything you are supposed to receive?

Background

ERISA Section 406(a)(1)(c) provides that the furnishing of goods, services or facilities between a plan and a party in interest is a prohibited transaction. Code Section 4975 imposes excise taxes on prohibited transactions and disqualified persons. ERISA defines a "party in interest" as anyone providing services to a plan. Engaging in a prohibited transaction is not a good thing; it could result in civil and financial penalties.

But ERISA Section 408(b)(2) provides relief from the prohibited transaction rules for service contracts/arrangements between a plan and a party in interest if:

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The Pension Plan Fix-It Handbook Welcomes New Contributing Editor

We are happy to introduce Mary B. Andersen as the new contributing editor of *The Pension Plan Fix-It Handbook*. Ms. Andersen is president and founder of ERISAdiagnostics Inc., an employee benefits consulting firm that provides services related to Forms 5500, plan documents, summary plan descriptions and compliance/operational reviews. Ms. Andersen has more than 25 years of benefits consulting and administration experience. In addition to her strong ERISA technical background, she is recognized as an effective and pragmatic executive and responsive consultant.

Ms. Andersen and her firm believe that risk management is a major aspect of daily corporate activities. Risks associated with employee benefit plans often do not receive the required attention until there is a crisis. The penalties and potential lawsuits that result from overlooking these risks can be significant. Demonstrating compliance is paramount.

Ms. Andersen has been a frequent speaker on compliance-related issues. She was an instructor for the International Society of Certified Employee Benefit Specialists (ISCEBS) program at the College of Insurance in New York. She served on the board of the American Society of Pension Professionals and Actuaries (ASPPA) Benefits Council of the Delaware Valley. She served on the board of the Central Pennsylvania chapter of ISCEBS in many capacities, including that of president, and has published several benefits-related articles. Ms. Andersen is a graduate of Western Michigan University with a BS in Math. She is also a CEBS fellow and member of the charter class, and has achieved the enrolled retirement plan agent (ERPA) designation from the IRS.

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1) the contract is reasonable;
2) the services are necessary for the establishment and operation of the plan; and
3) no more than reasonable compensation is paid for services for the plan. (There has been minimal guidance regarding what constitutes reasonable compensation.)

ERISA requires plan fiduciaries to act in the best interest of plan participants, which includes using plan assets for the exclusive benefit of plan participants. This implies that plan fiduciaries should minimize expenses charged to the plan to the extent possible. However, this does not mean that plan fiduciaries must choose the least expensive vendor. Plan sponsors must evaluate services provided for the fees charged.

Plan fiduciaries have the duty to select and monitor plan providers. Fundamental to this responsibility is having enough information to make an informed decision about the costs as well as the services provided.

The Interim Regulations

The interim regulations establish the disclosure requirements necessary for responsible plan fiduciaries and covered service providers to satisfy the reasonable contract requirement and avoid a prohibited transaction with respect to services (described in the regulations) rendered to a covered plan (see box on page 10 for relevant terms).

Expected Disclosures

The required disclosures must be provided in writing; no formal contract is required; no particular format is required. The responsible plan fiduciary must decide whether it has enough information about the services to be provided and whether the cost is reasonable. As a practical matter, most recordkeepers and TPAs already provide detailed service agreements and will probably be impacted the least by the disclosure requirements.

It is important to note that the preamble to the interim final regulations indicates that the DOL is considering adding a requirement that a covered service provider furnish a summary disclosure statement that would include a roadmap for the plan fiduciary describing where to find further details.

A description of the services must be provided as well as a statement of whether the covered service provider will be providing services as a fiduciary, an RIA or both. TPAs and recordkeepers are not fiduciaries; RIAs are fiduciaries. It will be interesting to see how broker dealers respond to this question.

Direct and indirect compensation must be disclosed and can be provided on an aggregate basis or itemized on a service-for-service basis. Indirect compensation should reflect the identification of services and the payer of the indirect compensation. A description of the manner in which compensation will be received — billed or deducted from the participant's accounts or investments — must also be provided.

Compensation among related parties must be disclosed. The covered service provider must separately disclose such compensation if it is set on a transaction basis (for example, commissions, soft dollars, finder's fees or other incentive compensation based on business placed or retained). In addition, disclosures must be made about the services for which such compensation will be paid, the payers and recipients of such compensation, and the status of each payer or recipient as an affiliate or subcontractor.

A description of any compensation that the covered service provider reasonably expects to receive upon the termination of the contract must be provided, as well as an explanation of how any prepaid amounts will be calculated and refunded upon termination.

The covered service provider must furnish a description of all direct and indirect compensation that the covered service provider expects to receive with respect to recordkeeping services.

If the recordkeeping services will be provided, in whole or in part, without explicit compensation or if the compensation is offset or rebated based on other compensation received by the service provider, a reasonable good faith estimate of the cost to the covered plan must be provided, including an explanation of the methodology and assumptions used to prepare the estimate.

Investment disclosures must include a description of:

- any compensation 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, sales charges, deferred sales charges, redemption fees, surrender charges, exchange fees, account fees and purchase fees);
- annual operating expenses (for instance, expense ratio) if the return is not fixed; and

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Fee Disclosure (continued from p. 2)

- ongoing expenses in addition to annual operating expenses (such as wrap fees, mortality and expense fees).

A separate disclosure is required for recordkeeping and brokerage services for each designated investment alternative (participant fund choices in a defined contribution plan, for instance). This requirement can generally be satisfied by providing current disclosure materials provided by the designated investment alternative.

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When Should Disclosures Be Received?

The covered service provider must disclose the required information in advance of the date the contract/arrangement is entered into, extended or renewed. There is an exception for designated investment alternatives that are added after the initial contract; such disclosures must be made as soon as practicable but not later than the date the investment alternative is designated by the responsible plan fiduciary.

Changes to the information already disclosed must be made no later than 60 days from the date the covered service provider is informed of the change, unless extraordinary circumstances would prevent it.

The covered service provider must also provide any information needed to comply with ERISA's reporting disclosure requirements upon the written request of the responsible plan fiduciary. The covered service provider must provide the information within 30 days, unless extraordinary circumstances would prevent it.

The responsible plan fiduciary must be notified of any disclosure errors as soon as practicable, but not later than 30 days from the date the covered service provider becomes aware of any error or omission.

What Should Plan Sponsors Do Now?

1) Identify your responsible plan fiduciary — probably an individual in smaller companies and a committee in larger companies or someone appointed by the committee.
2) Refer to the June and July 2010 newsletters regarding retirement fees and make sure you understand the various fee components and who gets what.
3) Identify all the plan's service providers.
4) Determine if the service providers are in the category of "covered service provider"; talk to your service provider and make sure you are on the same page. If the service provider is not a covered service provider, document the reasons.
5) Review the information currently provided by your covered service provider and determine if it meets the requirements of the interim regulations. TPAs and recordkeepers generally have detailed service agreements; broker dealers and RIAs may not.
6) Talk to your covered service provider and ask if it believes that its disclosures meet the requirements of the interim regulations; get its response in writing!
7) Document, document, document!