



Pension Analyst

Important information

Plan administration and operation

September 2010

DOL requires service providers to disclose fees to fiduciaries

Who's affected

This guidance applies to sponsors of defined benefit and defined contribution plans (including 403(b) plans) that are subject to ERISA. This guidance does not apply to governmental plans, church plans that do not elect to be covered by ERISA ("nonelecting church plans"), non-ERISA 403(b) plans, and unfunded excess benefit plans.

Background and summary

On July 16, 2010, the Department of Labor (DOL) issued long-awaited [interim final rules](#) requiring certain service providers to disclose fee information to fiduciaries of defined benefit and defined contribution plans (including 403(b) plans) that are subject to ERISA. Since these rules differ significantly from the proposed rules issued in 2007, the DOL accepted comments until August 30, 2010.

These rules are second in a three-part series of DOL guidance on fee transparency. The first piece of guidance was issued as revisions made to Form 5500, Schedule C, effective for plan years beginning on or after January 1, 2009. The third piece of guidance regarding fee disclosure to defined contribution plan participants is expected to be published this fall.

ERISA requires plan fiduciaries to act prudently and solely in the interest of plan participants and beneficiaries when selecting or monitoring service providers and plan investments. Plan fiduciaries must also act for the exclusive purpose of providing benefits and defraying reasonable expenses of administering the plan. To fulfill these responsibilities and make informed decisions, plan fiduciaries must have complete and accurate information. To that end, the DOL has provided these interim final rules requiring service providers to disclose fee information to plan fiduciaries.

The new rules are effective July 16, 2011, providing service providers one year from the date the rules were published to comply.

Action and next steps

Employers that sponsor defined contribution and defined benefit plans subject to ERISA should familiarize themselves with this DOL guidance. While service providers will be responsible for providing timely disclosures to covered plans in accordance with these rules, the DOL generally expects plan fiduciaries to use the disclosure information to fulfill their fiduciary duties to select and monitor service providers and investments in the best interest of plan participants.

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The furnishing of goods, services, or facilities between a plan and a party in interest to the plan is generally a prohibited transaction under ERISA. Since any person providing services to a plan is defined by ERISA to be a "party in interest," the relationship between a service provider and a plan would be a prohibited transaction, absent an exemption. ERISA provides a prohibited transaction exemption for plan service arrangements if all of the following conditions are met:

- The contract or arrangement between a service provider and plan is reasonable;
- The services are necessary for the establishment or operation of the plan; and
- No more than reasonable compensation is paid for the services.

The interim final rules add a new requirement that in order for a contract or arrangement to be considered reasonable, certain fee disclosures must be provided to a responsible plan fiduciary. A responsible plan fiduciary is a fiduciary with the authority to enter into, extend, or renew a contract or arrangement for plan services.

Covered plans

Service providers generally must provide fee disclosures to defined benefit and defined contribution plans (including 403(b) plans) that are subject to ERISA. While governmental plans, nonelecting church plans, and unfunded excess benefit plans are currently not required to receive these disclosures, similar rules could eventually apply to these types of plans.

Covered service providers

The interim final rules require service providers, such as Prudential Retirement, to provide certain disclosures to plans that are covered by the final rules, if the service provider reasonably expects to receive \$1,000 or more in [direct](#) or [indirect](#) compensation by providing one or more of the following services:

- Services as either a fiduciary or registered investment advisor;
- Recordkeeping or brokerage services provided directly to participant-directed defined contribution plans, if one or more designated investment alternatives will be made available through a platform or similar mechanism in connection with the services; and
- Services for which the service provider reasonably expects to receive indirect compensation, including accounting, auditing, actuarial, appraisal, banking, consulting related to the development or implementation of investment policies or objectives, consulting related to the selection or monitoring of service providers or plan investments, custodial, insurance, investment advice (plan sponsor or participant level), legal, recordkeeping, securities, or other investment brokerage, third party administration or valuation services provided to the plan. If any of these services result in direct compensation to the service provider, they are not required to be disclosed.

An affiliate or subcontractor of the covered service provider is not considered a covered service provider.

Compensation

For purposes of the interim final rules, direct compensation is defined as compensation the covered service provider receives directly from the plan. Indirect compensation is defined as compensation received from any source other than the covered plan, the plan sponsor, the covered service provider, an affiliate, or a subcontractor. Compensation which a service provider receives directly from the plan sponsor is neither direct nor indirect.

Compensation may be disclosed as a monetary amount, a formula, a percentage of the covered plan's assets, or a per capita charge for each participant or beneficiary. If the compensation cannot reasonably be expressed in one of those manners, another reasonable method may be used. Nonmonetary compensation of \$250 or less over the term of the contract is not included as compensation.

Disclosure requirements

The interim final rules require the disclosure to be in writing. The disclosure is permitted to be delivered electronically. The covered service provider must disclose the following information to a responsible plan fiduciary:

- A description of the services to be provided;
- A statement that the covered service provider will provide any services as a fiduciary or as a registered investment advisor, if applicable;
- A description of all direct compensation, in the aggregate or by service, the covered service provider expects to receive;

- A description of all indirect compensation that the covered service provider, its affiliates, or its subcontractors reasonably expects to receive from third-parties for services provided to the plan. This description must identify the services for which the indirect compensation will be received, as well as the payer of the indirect compensation;
- A description of the compensation that will be paid among the covered service provider, its affiliates, and its subcontractors for services provided to the plan *only* if it is either:
 - Set on a transaction basis (e.g., commissions, soft dollars, finder's fees or other similar incentive compensation based on business placed or retained); or
 - Charged directly against the covered plan's investment and reflected in the net value of the investment (e.g., Rule 12b-1 fees);
- A description of any compensation that the covered service provider, its affiliates, or subcontractors reasonably expect to receive in connection with termination of the contract or arrangement, and how any prepaid amounts will be calculated and refunded upon termination;
- If recordkeeping services will be provided to the plan, the provider must also disclose the following information:
 - A description of the direct and indirect compensation the covered service provider, affiliate, or subcontractor reasonably expects to receive for the recordkeeping services; and
 - If all or part of the recordkeeping services will be provided without explicit compensation (i.e., bundled) or if the compensation is offset or rebated based on other compensation received by the covered service provider, affiliate, or subcontractor, a reasonable and good faith estimate of the cost to the plan of the recordkeeping services. This estimate must include an explanation of the methodology and assumptions used to prepare the estimate and a detailed explanation of the recordkeeping services that will be provided to the plan. The estimate should take into account the rates that the covered service provider, an affiliate, or a subcontractor would charge to, or be paid by, third parties, or the prevailing market rates charged, for similar recordkeeping services for a similar plan with a similar number of participants and beneficiaries.
- A description of the manner in which the compensation will be received, such as whether the plan will be billed or whether the compensation will be deducted directly from plan accounts or investments;
- Fiduciaries to an investment contract, product, or entity that holds plan assets in which the covered plan has a direct equity investment and covered service providers that provide recordkeeping services to participant-directed defined contribution accounts must disclose the following information regarding plan investments:
 - A description of any compensation that will be charged directly against the amount invested in connection with its acquisition, sale, transfer of, or withdrawal from the investment contract, product, or entity (e.g., sales loads, sales charges, deferred sales charges, redemption fees, surrender charges, exchange fees, account fees, and purchase fees);
 - A description of the annual operating expenses (e.g., expense ratio) if the return is not fixed; and
 - A description of any ongoing expenses in addition to annual operating expenses (e.g. wrap fees, mortality and expense fees).

To meet this requirement, recordkeepers and brokers may distribute the information they receive from investment providers, as long as the investment provider is not an affiliate of the recordkeeper or broker, the disclosure materials are regulated by a State or federal agency, and the recordkeeper or broker has no knowledge that the materials are incomplete or inaccurate.

The interim final rules allow these disclosures to be provided in multiple documents. While the interim final rules do not require the disclosure to follow a certain manner or format, the DOL may consider revising the final rules to include specific standards for the format, as well as a possible "summary" disclosure statement.

Disclosure timing

A covered service provider must provide the disclosures to the responsible plan fiduciary reasonably in advance of the date the contract or arrangement is entered into, extended, or renewed. Subsequent changes to the disclosed information must be provided as soon as practicable, but not more than 60 days from the date the service provider has knowledge of the change. These rules do not require "annual" disclosure to the covered plan fiduciaries.

Generally, within 30 days of a written request from the responsible plan fiduciary or covered plan administrator, a covered service provider must also provide any other information required for the plan to comply with the reporting and disclosure requirements of ERISA, including information necessary for Form 5500, Schedule C. *It is important to note, however, that the reporting rules of Schedule C differ significantly from the new fee disclosure rules in many respects. For example, while these interim final rules are limited to "covered service providers," Schedule C reporting requirements extend*

beyond “covered service providers.” Additionally, the service provider fee disclosure rules apply to both large and small plans, while the Schedule C reporting requirements generally apply only to plans with 100 or more participants.

Information about new plan investment alternatives must be provided as soon as practicable, but not later than the date the investment alternative is made available under the plan.

Disclosures for contracts that were in place before the effective date of the final rules must be provided to responsible plan fiduciaries by July 16, 2011.

Relief for covered service providers

If a covered service provider makes an error or omission when disclosing the required information, the provider will have an opportunity to avoid a prohibited transaction. To obtain this relief, the service provider must disclose the correct information as soon as practicable, but no later than 30 days from the date the service provider discovers the error.

Relief for responsible plan fiduciaries

The interim final rules also include relief to protect responsible plan fiduciaries from engaging in a prohibited transaction in the event a covered service provider fails to disclose the required information. To be eligible for the relief, the responsible plan fiduciary must meet the following conditions:

- The plan fiduciary did not know the service provider failed to disclose the required information and reasonably believed the required information was disclosed;
- Upon discovering the failure, the plan fiduciary makes a written request to the service provider to provide the information; and
- If the service provider fails to comply with the plan fiduciary’s written request within 90 days of the request, the plan fiduciary must notify the DOL of the service provider’s failure. The notification to the DOL must occur no later than 30 days following the earlier of:
 - The service provider’s refusal to provide the requested information, or
 - 90 days after the written request to the service provider is made.

The DOL has provided a [sample notice](#) the plan fiduciary may use to notify the DOL of a service provider failure.

Effective date and next steps

The interim final rules are effective July 16, 2011. The DOL accepted comments on the rules until August 30, 2010. Although the DOL doesn’t anticipate significant changes to the rules as a result of the comment period, we will notify you of any subsequent changes to the rules, or any legislative developments that will affect you.

As discussed in our August [Washington Update](#) publication, Prudential Retirement began taking steps a number of years ago to ensure that plan sponsors receive timely, accurate, and useful fee disclosures before entering into a contract with Prudential as a provider. In addition, Prudential then began providing updated fee disclosures to our clients annually. We are currently reviewing these disclosures, in addition to the services that Prudential provides and the compensation that it receives, to identify any changes or additions that may be required to fully comply with the interim final rules. Prudential will notify you of any revisions to our disclosures before the effective date of July 16, 2011.

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