Employee Benefits & Executive Compensation Update

Service Provider Fee Disclosure Rules Are Finally Here: What Should Plan Sponsors Now Be Doing To Comply?

As of July 1, 2012, we arrived at the first plan fee disclosure compliance date addressing the mutual obligations of plan service providers and plan sponsors to disclose service fees payable from plan assets.

Practice Group Members

Amy L. Blaisdell
apb@greensfelder.com
314.516.2642 – St. Louis

Kathi L. Chestnut
klc@greensfelder.com
314.516.2650 – St. Louis

Daniel N. Janich
dnj@greensfelder.com
312.558.1070 – Chicago

Joseph R. Meives
jrm@greensfelder.com
314-516-2626 – St. Louis

Thomas H. Mug
thm@greensfelder.com
314.345.4732 - St. Louis

Douglas S. Neville
dsn@greensfelder.com
314.345.4742 – St. Louis

Garrett C. Reuter
gcr@greensfelder.com
618.239.3609 – Belleville

Daniel J. Schwartz
djs@greensfelder.com
314.516.2636 – St. Louis

Mary V. Khouri
mvk@greensfelder.com
314.345.4767 – St. Louis

Mary Benson
meb@greensfelder.com
314.345.4714 – St. Louis

As reported in our Fall 2010 and Spring 2012 newsletter *Updates*, plan sponsors and administrators must be fully cognizant of the final regulations issued pursuant to ERISA §408(b)(2) which for the first time require that service providers fully disclose the direct and indirect compensation they receive for providing services to ERISA covered retirment plans.

The impetus for the service provider regulations is to mandate full disclosure of what the service providers receive—from all sources either directly or indirectly—in payment for services provided to a covered plan. Such payments may be direct, such as from the plan, or indirect, such as from revenue sharing arrangements or finders or referral fees derived from issuers of plan investments. Fees paid solely from the assets of the plan sponsor—generally the employer—rather than from the plan are not subject to the fee disclosure regulations.

It is principally the indirect compensation that remained undisclosed to plan sponsors, precluding them from assessing whether the total compensation paid to the service provider was "reasonable" for purposes of establishing an exemption from ERISA's prohibited transaction rules.

§408(b)(2) Compliance Checklist for Plan Sponsors

The following checklist details issues that a plan sponsor must address to ensure a service provider's compliance with the §408(b)(2) final regulations. In a separate upcoming newsletter we will address how a plan sponsor should prepare for the August 30, 2012, plan participant fee disclosure deadline under the ERISA §404(c) final regulations.

1. Who Must Comply?

§408(b)(2) final regulations apply to—

"Covered Service Providers" (CSPs) that reasonably expect to receive either directly or indirectly compensation of $1,000 or more. These include:

- Fiduciaries and regulated investment advisors;
- Record keepers and brokers (other than self-directed brokerage accounts) for self-directed defined contribution plans, such as 401(k) plans; and
- A "catch all" category comprised of anyone who is providing various specialized services to the plan, such as accounting, auditing, actuarial, appraisal, banking, consulting, custodial, insurance, investment advisory, legal, recordkeeping, valuation, third party administrator ("TPA"), or other investment brokerage services, provided that they also receive indirect compensation for such services.

2. Which Plans Are Covered?

Only ERISA covered plans are subject to the §408(b)(2) rules. Thus neither church plans nor governmental plans are required to follow these rules. Furthermore, these rules apply specifically to ERISA covered retirement plans. The Department of Labor (DOL) has announced that it plans to issue a separate set of regulations on fee disclosure for health and welfare plans covered by ERISA. Until the current set of §408(b)(2) regulations are fully implemented, you should not anticipate that the DOL will address the health and welfare plan fee disclosure requirements.

Also it is worth noting that old 403(b) programs that satisfy certain requirements not stated here might also be excluded from the fee disclosure requirements. If you have such a plan, you should contact us for further guidance.

3. What Must Be Disclosed?

CSPs must disclose in writing—

- the service they provide;
- whether they are fiduciaries or registered investment advisors; and
- how much money they receive — either directly or indirectly — for services.

The category of service provider and type of compensation received may affect what must actually be included in order to fully comply with these fee disclosure rules.

CSPs that provide "bundled services" to a plan will be required to separate their recordkeeping services for purposes of disclosure and provide an estimate of their "cost" of providing such services.

Plan administrators must provide participants plan fee information relating to plan investment options if the plan is self-directed. This information would include, for example, expense ratios, historic performance, benchmark comparisons and a website reference for the investment. Because the plan sponsor in all likelihood will not have this information, it is the CSP who must provide this required information to the plan administrator so that the administrator can pass it along to the participants.

A "pass through safe harbor" will release TPAs and other CSPs from responsibility for the data that they simly receive from an investment issuer and pass it along to the plan administrator.

Currently unresolved is whether a plan sponsor seeking reimbursement from the plan for service provider fees previously paid would need to disclose these fees under the §408(b)(2) regulations.

4. When Must Disclosure Occur?

Plan fee disclosure information must be made available before the plan sponsor iniitally hires the service provider or otherwise renews or extends the account. Consequently, the rules require that disclsoure be made "reasonably in advance" of when the contact with the service provider is entered into, extended, or renewed.

For service provider agreements existing on July 1, 2012, a "catch up" disclosure (i.e., one that is forward looking) must be provided on or before that date.

Any change in the disclosure information must be given to the plan administrator within 60 days of the service provider's knowledge of same. Investment related disclosures are to be updated annually.

For investment products where information is not currently available, compensation information must be provided to the plan administrator within 30 days from the date the investment product holds plans assets.

5. What If The Service Provider Does Not Comply?

Noncompliance with the §408(b)(2) rules means that providing services is a prohibited transaction, resulting minimally in a nondeductible excise tax of 15% of the "amount involved," which may equal all fees charged to the plan by the service provider involved! Also, if the "responsible plan fiduciary" (RPF) - generally plan administrator - does not receive the required disclosure and also fails to take affirmative action to obtain it from the delinquent service provider, the RPF may be treated as responsible for the prohibited transaction and in a breach of its fiduciary duties.

To avoid this treatment, an RPF must send the CSP a written request for the information and, if not provided within 90 days thereafter, send the DOL (within the following 30 days) a completed copy of the Fee Disclosure Failure Notice reporting the failure and terminating the CSP relationship.

There is no penalty arising from an information error committed by the CSP if it is timely corrected within 30 days after its discovery.

A Plan Sponsor Action Plan for §408(b)(2) Compliance

The following information addresses what you should be doing now wiht morass of data you receive from service providers and what other steps we recommend that you consider taking at this time.

1. Ensure All Data Has Been Received. Prepare a list of all plan service providers that are CSPs, i.e., subject to the §408(b)(2) regulations, and determine what types of disclosures the rules require of each. Ensure that you have received all data required from the service providers, including all classes of information needed to be disclosed.

2. Assess Data Received. From the data, plan sponsors are expected to assess the reasonableness of the total compensation (direct and indirect) received by their plan service providers. The mere receipt of data and reporting of it on Form 5500 is not enough. Plan sponsors are expected to determine, after a thorough evaluation of the data, whether a change in service providers is warranted. In this regard, you may want to consider whether it is best to evaluate that data yourself or hire one or more advisors (such as a benchmarking service) to assist in the review process.

3. Revise or Amend Serivce Provider Agreements. To ensure compliance with the §408(b)(2) regulations, a plan sponsor should collect and review its relevant service provider agreements to determine whether any revisions or amendments are needed to comply with the fee disclosure requirements. Such revisions may include service provider termination provisions arising from a faiure to timely provide the plan administrator with all fee disclosure information required by §408(b)(2) or a description of circumstances that warrant a fee schedule change. The plan sponsor may also want to consider including a provision that permits possible claim recovery or indemnification for any excise taxes and related expenses arising from service provider noncompliance.

Finally, a plan sponsor should also ensure that any revision or amendment to an agreement has been properly implemented with the service provider.

Employee Benefits & Executive Compensation Update is published quarterly to inform our clients and friends of important employee benefits and executive compensation issues that may impact their business operations and employment relationships.

Back issues of this newsletter publication are available for review and/or download at the Greensfelder, Hemker & Gale, P.C. website www.greensfelder.com. If there is any subject matter that you would like us to address in an upcoming issue, we would welcome hearing from you.