



ERISA ALERT

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Retirement Plan Service Providers Must Disclose Fees; Fiduciaries Also on the Hook

If you are a retirement plan fiduciary or service provider, you need to be aware of new DOL regulations that may subject you to excise taxes or breach of fiduciary duty claims. Under new Interim Final Regulations (referred to herein as the "new regulation"),¹ many providers of services to retirement plans will have to provide specific disclosures regarding their compensation and fee arrangements, and plan fiduciaries will have to ensure that they do so. Failure to comply will constitute engaging in a prohibited transaction under ERISA Section 406 and Section 4975 of the Internal Revenue Code. The service provider may be subject to excise taxes and the fiduciary who caused the retirement plan to retain a service provider who fails to make the required disclosures may be liable for a breach of fiduciary duty under ERISA.

The current rule. Services provided to an employee benefit plan are covered by ERISA's and the IRS's "prohibited transaction" provisions, unless:

- i. the services are necessary for the establishment or operation of the plan;
- ii. provided pursuant to a contract or arrangement that is reasonable; and
- iii. for reasonable compensation.

But what does "reasonable" mean? Current regulations are unclear, saying only that a contract or arrangement is not reasonable unless it permits the plan to terminate the contract or arrangement without penalty on reasonably short notice.

The new regulation. This "reasonableness" question is the heart of the new regulation. Now, in order for a contract or arrangement with a covered service provider to be deemed "reasonable," the covered service provider must disclose certain information about its compensation to the fiduciary who has the authority to cause the employee benefit plan to enter into, extend or renew the contract or arrangement. Failure to do so will render the agreement between the plan and the service provider a "prohibited transaction." The service provider may be subject to excise taxes, and the plan fiduciary may be deemed to have breached its fiduciary duty by not ensuring that the service provider complied.

Who is a "covered service provider"? The new regulation imposes disclosure obligations (described below) on the following service providers who expect to receive compensation of \$1,000 or more (defined in the new regulation as "covered service providers"):

- Persons providing services to the plan as ERISA fiduciaries or registered investment advisers
- Persons providing recordkeeping or brokerage services to a 401(k) or other participant-directed individual account plans
- Persons who expect to receive indirect compensation² for providing accounting, auditing, actuarial, appraisal, consulting, custodial, insurance, investment

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advisory, legal, recordkeeping, securities or other investment brokerage, third party administration or valuation services to a plan

What must be disclosed? Covered service providers must disclose:


- A description of the services to be provided and, if applicable, a statement that the services will be provided as a fiduciary
- A description of all direct compensation, either in the aggregate or by service, that the covered service provider, affiliate or subcontractor expects to receive
- A description of all indirect compensation that the covered service provider, affiliate or subcontractor expects to receive, including identification of the services provided in connection with the indirect compensation and the identity of the payer of such indirect compensation
- A description of direct and indirect compensation that is determined on a transaction basis or charged directly against the plan's investment and reflected in the investment's net value
- A description of any compensation that the covered service provider, affiliate or subcontractor expects to receive in connection with the termination of the contract or arrangement
- If recordkeeping services are being provided, then the covered service provider must provide a description of all direct and indirect compensation that the covered service provider, affiliate or subcontractor expects to receive for recordkeeping services and, if the recordkeeping services are being provided, in whole or in part, without explicit compensation or if the compensation is being offset or rebated based on other compensation, then a reasonable and good faith estimate of the cost to the covered plan of such recordkeeping services
- A description of the manner in which compensation will be received (e.g., compensation will be billed directly or deducted from the plan's investments)
- Additional information with respect to investment products if fiduciary services are being provided (such as a description of the annual operating and other ongoing expenses)

The required disclosures must be made prior to entering, renewing or extending a contract or arrangement with a covered plan. The covered service provider must also inform the plan fiduciary of any changes to the required disclosures as soon as practicable but no later than 60 days from the date of a change.

What if the Required Disclosures are not made? As noted above, a service provider's failure to make the required disclosures carries consequences for both the provider and the plan's fiduciary.

- Consequences for the service provider. As noted above, a covered service provider will be considered to have entered into a prohibited transaction with a plan under Section 4975 of the Internal Revenue Code as a result of its failure to make the required disclosures under the new regulation. Under Section 4975, the

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service provider will generally be liable for an excise tax equal to 15% of the amount involved (e.g., the compensation paid by the retirement plan).

- Consequences for the plan fiduciary. The plan fiduciary may be in breach of its fiduciary duties if a covered plan enters into a contract or arrangement for services with a covered service provider who fails to make the disclosures required by the new regulation. Under the new regulation, a plan fiduciary will be eligible for an exemption from the prohibited transactions rules where the plan fiduciary was unaware that the required disclosures were not made and reasonably believed that the covered service provider disclosed all necessary information. Upon discovering the failure to make the required disclosures, the plan fiduciary must make a written request for the correct or missing information from the covered service provider. If the covered service provider refuses to provide the missing information or fails to furnish the information within 90 days after the written request, the plan fiduciary must notify the DOL of such refusal or failure.

When is the new regulation effective? The new regulation will apply to all service contracts or arrangements between covered plans and service providers on or after July 16, 2011, including existing contracts and arrangements entered into prior to that date. The new regulation covers only defined contribution and defined benefit plans. Individual retirement accounts, simplified employee pension plans and welfare plans are not covered.

What to do now. Since the new regulation will now apply to contracts and arrangements entered into, renewed or extended prior to the effective date of July 16, 2011, plan fiduciaries should identify their covered service providers and assess what additional information will be required. In order to monitor ongoing compliance with the new regulation, plan fiduciaries should also develop procedures for monitoring and reviewing the disclosures being made by covered service providers.

This alert is one in a series on the topic of ERISA and employee benefits. To read past alerts, please [click here](#). For more information on this alert or other ERISA matters, please contact:

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(1) As discussed in this alert, the interim final regulations do not apply to welfare plans. The DOL has reserved space in DOL Regulation §2550.408b-2 where it intends to develop disclosure requirements specifically tailored to welfare plans.

(2) For purposes of the new regulation, indirect compensation is generally compensation from a source other than the covered plan, the plan sponsor, a covered service provider or an affiliate.

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