

# Employee Benefits Briefing

## Service Provider Fee Disclosure: Another Step Towards Fee Transparency

Plan fiduciaries who are in the midst of implementing the new Form 5500 Schedule C requirements for service provider fees may not want to think about additional fee disclosures. But, on July 16, the Department of Labor (DOL), concluding that Congress did not intend to act on this issue, released an interim final regulation requiring service providers to make additional disclosures to plan fiduciaries.

... it is principally plan fiduciaries  
who will have significant new  
responsibilities

This regulation emphasizes service providers' obligations to furnish additional disclosures to the plan fiduciary. Yet, in fact, it is principally plan fiduciaries who will have significant new responsibilities under this regulation since the regulation describes the conditions that must be satisfied for the plan fiduciary to avoid a prohibited transaction.

### *Background*

The DOL's first effort towards fee transparency was the publication of the Form 5500 Schedule C requirements which are effective for the 2009 plan year. The second effort consists of these fee disclosure requirements, which were originally published as a proposed regulation and a proposed class exemption on December 13, 2007. In the interim, several legislative proposals were introduced, but no proposal was enacted. As a result, the DOL released this revised version of the

regulation as an interim final regulation (i.e., subject to further comment by August 30).

### *Summary*

***The following summary looks at the regulation from the responsible plan fiduciary's perspective.*** The regulation uses the term responsible plan fiduciary, which means the plan fiduciary in control of the service provider arrangement.

#### **A. When Is the Regulation Effective and Which Plans are Involved?**

- **Timing.** The regulation is effective July 16, 2011, one year from the date of issuance. On that date, it applies to all covered service contracts then in place. Thus, for contracts in existence at that time, the information must be received by July 16, 2011. Thereafter, in general, the information must be provided reasonably in advance of the date the service provider contract is entered into, extended or renewed. Changes in information already provided must generally be made as soon as possible but no later than 60 days from when the service provider is informed of the change. Good-faith reasonable disclosure errors or omissions by the service provider should be corrected as soon as practicable, but no later than 30 days after the service provider learns of the error or omission.
- **Plan Coverage.** The current rule applies to ERISA pension plans, both defined benefit and defined contribution. (The DOL rejected

arguments seeking to exempt small plans (fewer than 100 participants.) The rule is inapplicable to IRAs. While the rule will eventually apply to welfare plans, that part of the rule has been reserved for now.

- **Exclusivity.** The regulation specifically provides that it must be followed in order for a service contract to be reasonable as required for the statutory prohibited transaction exemption. Thus, the prohibited transaction exemption in ERISA Section 408(b)(2) will arguably not be available if the procedures are not followed.

## B. What Steps Should Plan Fiduciaries Be Prepared to Take?

The regulation does not require that existing service contracts be amended to reference the disclosure obligations. Still, most fiduciaries will want any new service contracts to include the service provider's obligations in this area.

Under the regulation, responsible plan fiduciaries need to be prepared to implement a disclosure process which consists essentially of 4 steps:

- **STEP ONE**—Covered service providers must furnish the responsible plan fiduciary with disclosures relating to fees. A service provider is exempt from the regulation if it reasonably does not expect to receive \$1,000 or more in direct and indirect compensation during the term of the arrangement. Compensation is anything of monetary value (direct or indirect) in excess of \$250. However, fees paid by the plan sponsor are not either direct or indirect compensation under the regulation.

*A Covered Service Provider is One Who (or Who Through an Affiliate or Subcontractor) Provides:*

1. Services as a fiduciary or registered investment adviser. This includes:

- ◆ Services provided directly to the covered plan as an ERISA fiduciary;
- ◆ Services provided as a fiduciary to an investment contract, product, or entity that holds plan assets (as determined under the "plan asset" rules) and in which the covered plan has a direct equity investment (a direct equity investment does not include investments made by the investment contract, product, or entity in which the covered plan invests); or
- ◆ Services provided directly to the covered plan as a registered investment adviser.

2. Recordkeeping services or brokerage services provided to a covered plan that is an individual account plan and that permits participants or beneficiaries to direct the investment of their accounts, if one or more designated investment alternatives will be made available (e.g., through a platform or similar mechanism) in connection with such recordkeeping services or brokerage services.
3. Any of the following services, if the provider will receive indirect or related party compensation: accounting, auditing, actuarial, appraisal, banking, consulting (i.e., consulting related to the development or implementation of investment policies or objectives, or the selection or monitoring of service providers or plan investments), custodial, insurance, investment advisory (for plan or participants), legal, recordkeeping, securities or other investment brokerage, third-party administration, or valuation services provided to the covered plan.

Affiliates and subcontractors of a covered service provider are not themselves covered service providers.

Required Disclosures by Covered Service Providers:

1. A description of the **services to be provided** to the covered plan (but not including certain nonfiduciary services relating to an investment contract, product, or entity in which the plan invests).
2. A statement, where applicable, that the **status** of the person providing the services is as a fiduciary or as a registered investment adviser.
3. A description of all **direct compensation**, either in the aggregate or by service (required for recordkeeping), that the covered service provider, an affiliate, or a subcontractor reasonably expects to receive.
4. A description of all **indirect compensation** that the covered service provider, an affiliate, or a subcontractor reasonably expects to receive; the services for which the indirect compensation will be received; and the payer of the indirect compensation. If there is no explicit compensation for recordkeeping services, a good-faith estimate is required.
5. A description of any **compensation that will be paid among related parties**, the covered service provider, an affiliate, or a subcontractor, if it is 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 is charged directly against the covered plan's investment and reflected in the net value of the investment (e.g., Rule 12b-1 fees); the services for which such compensation will be paid; and the payers and recipients of such compensation (including the status of a payer or recipient as an affiliate or a subcontractor).
6. A description of any **compensation** that the covered service provider, an affiliate, or a subcontractor reasonably expects to receive **in connection with termination of the contract** or arrangement, and how any prepaid amounts will be handled.
7. A description of the **manner in which the compensation will be received** (e.g., billed or deducted directly).
  - **STEP TWO**—The plan fiduciary must determine that all covered service providers have reported and that the reports are complete and adequate. The fiduciary then reviews and evaluates the information it has received. If the information is complete, the fiduciary uses it to make the fiduciary's evaluation of the arrangement and determination of reasonableness.
  - **STEP THREE**—If the information is incomplete or if a covered service provider has not responded, the plan fiduciary must follow up with the service provider in writing. The service provider must generally respond within 30 days of the written request.
  - **STEP FOUR**—If the service provider refuses to respond or fails to respond adequately within 90 days, the fiduciary must, within 30 days of the refusal or failure, provide a detailed written notice to the DOL identifying, among other things, the defaulting covered service provider, the information not provided, and the date of the fiduciary's written request.

In connection with a failure or refusal to provide information, the plan fiduciary must also make a reasoned determination as to whether or not to continue the service arrangement.

## C. Conclusion

Covered service providers will need to develop processes for compliance with this regulation and provide timely and adequate information to plan fiduciaries. However, the burden of determining the

adequacy of their response and taking any appropriate action for inadequate responses rests with the responsible plan fiduciary. Otherwise, the prohibited transaction exemption for the responsible plan fiduciary may not be available.

If you have any questions regarding the fee disclosure regulation, please contact **John J. Jacobsen, Jr.** (312-609-7680), **Philip L. Mowery** (312-609-7642) or **Paul F. Russell** (312-609-7740).

**FEDERAL TAX NOTICE: Treasury Regulations require us to inform you that any federal tax advice contained herein is not intended or written to be used, and cannot be used, by any person or entity for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code.**

## VEDDERPRICE®

222 NORTH LASALLE STREET  
CHICAGO, ILLINOIS 60601  
312-609-7500 FAX: 312-609-5005

1633 BROADWAY, 47th FLOOR  
NEW YORK, NEW YORK 10019  
212-407-7700 FAX: 212-407-7799

875 15th STREET NW, SUITE 725  
WASHINGTON, D.C. 20005  
202-312-3320 FAX: 202-312-3322

[www.vedderprice.com](http://www.vedderprice.com)

### The Employee Benefits Group

Vedder Price has one of the nation's largest employee benefits practices, with ongoing responsibility for the design, administration and legal compliance of pension, profit sharing and welfare benefit plans with aggregate assets of several billion dollars. Our employee benefits lawyers also have been involved in major litigation on behalf of benefit plans and their sponsors. Our clients include large national corporations, smaller professional and business corporations, multiemployer trust funds, investment managers and other plan fiduciaries.

### Employee Benefits Group Members

|                                       |              |
|---------------------------------------|--------------|
| Mark I. Bogart                        | 312-609-7878 |
| Sara Stewart Champion                 | 212-407-7785 |
| Michael G. Cleveland                  | 312-609-7860 |
| Christopher T. Collins                | 312-609-7706 |
| Megan J. Crowhurst                    | 312-609-7622 |
| Thomas P. Desmond                     | 312-609-7647 |
| John H. Eickemeyer                    | 212-407-7760 |
| Thomas G. Hancuch                     | 312-609-7824 |
| Benjamin A. Hartsock                  | 312-609-7922 |
| Jonathan E. Hyun                      | 312-609-7791 |
| John J. Jacobsen, Jr.                 | 312-609-7680 |
| Michael C. Joyce                      | 312-609-7627 |
| Neal I. Korval                        | 212-407-7780 |
| Philip L. Mowery<br>(Practice Leader) | 312-609-7642 |

|                     |              |
|---------------------|--------------|
| Stewart Reifler     | 212-407-7742 |
| Paul F. Russell     | 312-609-7740 |
| Robert F. Simon     | 312-609-7550 |
| Patrick W. Spangler | 312-609-7797 |
| Kelly A. Starr      | 312-609-7768 |
| Jessica L. Winski   | 312-609-7678 |
| Charles B. Wolf     | 312-609-7888 |

### About Vedder Price

Vedder Price P.C. is a national, business-oriented law firm with more than 250 attorneys in Chicago, New York and Washington, D.C. The firm combines broad, diversified legal experience with particular strengths in labor and employment law, employee benefits, executive compensation, corporate finance and transactions and commercial litigation.

EMPLOYEE BENEFITS BRIEFING is published by the law firm of Vedder Price P.C. It is intended to keep our clients and other interested parties generally informed of legal developments in employee benefits. It is not a substitute for professional advice. For purposes of the New York State Bar Rules, this bulletin may be considered ATTORNEY ADVERTISING. Prior results do not guarantee a similar outcome.

© 2010 Vedder Price P.C. Reproduction is permissible with credit to Vedder Price P.C.