News | EMPLOYEE BENEFIT PLANS

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Department of Labor Fee Disclosure Regulations Become Effective July 1, 2012: Failure to Comply Will Result in a Prohibited Transaction

Earlier this year, the Department of Labor ("DOL") released its final regulations under Section 408(b)(2) of the Employee Retirement Income Security Act ("ERISA"). These final regulations replaced the interim final rule published on July 16, 2010 which, among other things, extended the effective date to July 1, 2012. Beginning on that date, covered service providers must make specific disclosures in order to meet the reasonable fee requirements of Section 408(b)(2).

Background

ERISA requires plan fiduciaries to act prudently and solely in the interest of plan participants and beneficiaries when selecting and 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 and, to that end, the DOL has provided these final regulations requiring service providers to disclose fee information to plan fiduciaries.

The disclosures are intended to help plan fiduciaries determine if their fee arrangements are reasonable. If the requirements are not met, the plan fiduciary and the service provider have engaged in a prohibited transaction that will subject the plan sponsor to an Internal Revenue Service excise tax penalty.

A Three-Step Process

These final regulations are the last step in a three-part process regarding increased disclosure of plan expense information. We will review each of the areas below.

Form 5500

The first reporting change was implemented with the enhanced Form 5500, Schedule C reporting requirements effective for plan years beginning on or after January 1, 2009. The instructions to Form 5500, Schedule C now include specific detailed information relating to direct and indirect payments to service providers. Failure to follow specific instructions for accurate filings can lead to significant fines.

Plan-Level Disclosures

The second reporting change requires "covered service providers" of ERISA covered retirement plans to disclose fee-related information about the service provider arrangement to the responsible plan fiduciary for purposes of determining whether the arrangement is reasonable. The final rule applies to covered service providers who expect at least $1,000 in compensation to be received for services to a covered plan.

The final rule applies to the following covered service providers:

- ERISA fiduciary service providers to a covered plan or to a "plan asset" vehicle in which such plan invests;
- Investment advisers registered under Federal or state law;
- Record-keepers or brokers who make designated investment alternatives available to the covered plan (e.g., a "platform provider"); and
- Providers of one or more of the following services to the covered plan who also receive "indirect compensation" in connection with such services:
  - Accounting, auditing, actuarial, banking, consulting, custodial, insurance, investment advisory, legal, recordkeeping, securities brokerage, third-party administration, or valuation services.

The covered service provider must disclose direct and indirect compensation in connection with the services they provide. The plan sponsor must take steps to determine that the fees paid to each covered service provider are deemed reasonable for the services rendered. If the plan sponsor does not consider the fees reasonable, corrective action must be taken. The covered service provider must also disclose services provided to the plan, its fiduciary status, and other relevant facts such as conflicts of interest. If a plan does not receive these disclosures from a provider, it is considered a fiduciary breach. This breach can be avoided by filing a complaint against that provider.

Participant-Level Disclosures

The last reporting change involves making disclosures to plan participants, its beneficiaries, and anyone eligible to participate in the plan. Final ERISA Section 404(a) regulations issued by the DOL are designed to ensure that employees and beneficiaries eligible to participate in participant-directed individual account plans are provided with enough information regarding the plan, designated investment options, fees, and expenses to effectively manage their individual plan accounts. The effective date for participant fee disclosure is 60 days after the effective date of this rule. Plan administrators must make the initial annual disclosure of "plan level" and "participant level" disclosures no later than August 30, 2012. The first quarterly disclosures are required 45 days after the end of the quarter in which the initial disclosure is required to be furnished. This date is November 14, 2012 and the following disclosures are required:

- General information about the structure of the plan, administrative fees and expenses that plan service providers charge, and specific information concerning the actual charges to plan participant individual accounts (provided on a quarterly basis).
- Comprehensive data about each of the plan's investment options, including historical performance, comparable benchmark performance, expense charges, and investment restrictions—all in a way that allows participants to make "meaningful" comparisons, in the form of a comparative chart, of their investment alternatives.

It is considered a fiduciary breach by the plan sponsor if they do not provide these disclosures. Plan sponsors must also take necessary steps to make sure that these disclosures are complete and accurate; otherwise they may be subject to penalities and potential litigation.

Final ERISA Section 404(a) regulations issued by the DOL are designed to ensure that employees and beneficiaries eligible to participate in participant-directed individual account plans are provided with enough information regarding the plan, designated investment options, fees, and expenses to effectively manage their individual plan accounts.

Action Plan

Plan sponsors need to take action to ensure that they are meeting all of their obligations under the new fee disclosure rules. Steps that should be taken to comply with these regulations include the following:

- Identify all of the "covered service providers" to which the fee disclosure rules apply;
- Contact the applicable parties to ensure that they will provide the fee disclosure information by the July 1, 2012 deadline;
- Establish an ongoing process to monitor and analyze fee disclosures and determine whether such arrangements are reasonable;
- Document the plan sponsor's service provider review process and conclusions made by the plan fiduciaries; and
- Determine how this information will be used in preparation of the participant-level disclosures.

If you have any questions regarding the DOL regulations pertaining to service provider fee disclosures for your company's retirement plan, please contact Kimberly Brandley, CPA, a J.H. Cohn partner and member of the Firm's Employee Benefit Plan Practice, at kbrandley@jhcohn.com or 732-380-8618, or Mathew Krukoski, CPA, a J.H. Cohn partner and member of the Firm's Employee Benefit Plan Practice, at mkrukoski@jhcohn.com or 860-368-5222. ■

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