Employee Benefits & Executive Compensation Bulletin
BRYAN CAVE

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DOL Issues New Service Provider Fee Disclosure Rules

Background

The disclosure of fees paid to service providers of defined contribution retirement plans has become a hot topic in the employee benefits world. Under ERISA, plan fiduciaries are required to act solely in the interest of participants and beneficiaries and pay only "reasonable" plan expenses. However, increased complexities within the retirement plan and financial services industries have made it more difficult for plan fiduciaries to fully understand the extent to which their service providers are being compensated, as well as whether any conflicts of interest exist. As a result, there is a growing consensus that increased disclosure of plan fees paid to service providers is necessary to help plan fiduciaries fulfill their duties.

A number of measures have recently been introduced in Congress that would require detailed disclosure of fees paid to service providers. These proposed laws follow a series of lawsuits filed against a number of Fortune 500 companies alleging that such companies' 401(k) plans were paying unreasonable fees and the companies did not adequately disclose such fees to plan participants.

Proposed Rule

At the end of 2007, the U.S. Department of Labor ("DOL") became involved in the fee disclosure issue by issuing its long-awaited proposed rule designed to enhance fee disclosure by fiduciaries of 401(k) and other defined contribution benefit plans. The purpose of the proposed rule is to help fiduciaries (1) determine the reasonableness of compensation paid to plan service providers, and (2) identify conflicts of interest that may affect a service provider's performance under a service contract or arrangement. The rule specifically proposes amending the regulation under Section 408(b)(2) of ERISA which provides an exemption from the prohibited transaction rules, to clarify what constitutes a reasonable contract or arrangement, and to require more comprehensive written disclosure concerning plan contracts with service providers. The proposed rule affects defined contribution plan sponsors, plan fiduciaries and plan service providers.

In the Press Release accompanying the announcement of the DOL's proposed rule, U.S. Secretary of Labor Elaine L. Chao stated:

"[o]ne of the department's top priorities is improved disclosure in order to ensure that participants and fiduciaries have the information they need to make informed decisions…We are working

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quickly to implement regulations that foster fair, competitive and transparent prices for services as well as combat excessive or hidden plan fees."

Consistent with these goals, the proposed rule requires enhanced disclosure of all compensation received by the service provider, both directly and indirectly.

Initial Disclosure Requirements

Specifically, the terms of a service provider contract must require that the service provider disclose information regarding all services to be performed and all compensation that will be received either directly from the plan or indirectly from parties other than the plan or plan sponsor. The proposed rule also specifies that this compensation information must be disclosed in writing before the plan fiduciary enters into the contract. While the proposed rule will require many service providers to monitor and disclose many types of compensation information for which disclosure was not previously required, the DOL incorporated certain rules designed to mitigate the resulting burden. Specifically, the proposed rule does not require that all the compensation information be contained in a single document and they allow a service provider to incorporate other documents in its disclosure by reference (e.g., referencing fee information contained in a prospectus is permissible).

Conflicts of Interest

The proposed rule also requires that a service provider disclose any conflicts of interest that might arise in the course of providing the services under the contract. Specifically, the proposal mandates the disclosure of the following: (1) whether the service provider or an affiliate will be acting as a fiduciary, under either ERISA or the Investment Advisers Act of 1940; (2) whether the service provider or an affiliate expects to acquire any financial interest in any transaction involving the plan that will be occurring in connection with the service arrangement; (3) whether the service provider or an affiliate has any material financial, referral, or other relationship it with any other parties that creates or may create a conflict of interest under the service contract; (4) whether the service provider or an affiliate has the ability to affect its own compensation (direct or indirect) without the prior approval of an independent plan fiduciary (such as "float" compensation); and (5) whether the service provider or an affiliate has policies and procedures in place to prevent and/or manage these conflicts of interest and explain those procedures.

Ongoing Disclosure Requirements

The proposal also includes ongoing disclosure obligations which relate to: (1) any material changes to information previously furnished during the term of the contract (service provider must disclose such material changes within 30 days); (2) disclosure of compensation or other information related to the contract or arrangement that is requested by the responsible plan fiduciary or plan administrator in order to comply with ERISA's reporting and disclosure requirements; and (3) a requirement that service providers actually make the required disclosures discussed in (2).

Class Exemption

In a welcome move, the DOL's proposal also includes a class exemption to provide relief to plan fiduciaries who enter into deficient contracts with service providers that, without the knowledge of the fiduciaries, fail to comply with their disclosure obligations. This relief only applies when a contract or arrangement fails to be "reasonable," through no fault of the responsible plan fiduciary.

The DOL accepted written comments on the proposed rule and class exemption, and proposes to make the final rule effective 90 days after it is published. In light of the 401(k) plan fee litigation, fee-related proposed legislation and the proposed rule summarized above, it is clear that plan sponsors should expect dramatic changes in the very near future requiring enhanced disclosure of plan fee information.

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