New Fee Disclosure Rules for Service Providers to Pension Plans

New Regulations Issued by the Department of Labor Impose Detailed Fee Disclosure Rules on Service Providers to Pension Plans

SUMMARY

The Department of Labor recently issued interim final regulations (the “Interim Final Regulations”) imposing detailed fee disclosure requirements on certain service providers to pension plans, 401(k) plans and other similar arrangements. For the reasons discussed below, these regulations will be broadly applicable to service providers in the pension services industry and to the plan administrators and fiduciaries who hire them.

The Interim Final Regulations replace and modify in many respects regulations proposed by the Department of Labor on December 13, 2007. As a general matter, the Interim Final Regulations:

- Require “covered service providers” to provide the plan fiduciary of a “covered plan” a written description of the services provided and a written description of compensation received directly from the plan and compensation received from other parties, including compensation paid to affiliates of the service provider;
- Define “covered plan” to include primarily private domestic pension plans, 401(k) plans and other similar arrangements, but specifically do not apply to IRAs;
- Specifically do not apply to health, medical, disability, vacation plans, or other similar plans and arrangements, which are reserved for future regulatory guidance; and
- Define covered service providers generally as (1) service providers who are fiduciaries directly to the plan or to a vehicle or arrangement treated as holding assets of a plan under ERISA and the regulations thereunder, (2) certain service providers who provide investment platforms to participant directed individual account plans (such as 401(k) plans), and (3) service providers who receive indirect compensation or compensation from affiliates.
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The Department of Labor has invited public comment on the new regulations prior to August 30, 2010. If unchanged, however, the new regulations become effective July 16, 2011 in their current form. Service providers with respect to contracts or arrangements entered into before July 16, 2011 must comply with the new disclosure requirements as of that date.

BACKGROUND

The Employee Retirement Income Security Act of 1974, as amended (ERISA), generally prohibits a fiduciary to an employee benefit plan (i.e., pension plans, 401(k) plans, health plans and other similar arrangements) from causing the plan to enter into a transaction pursuant to which a party in interest to the plan provides services to the plan. Similarly, a fiduciary to the plan is prohibited from transferring the assets of the plan to or for the benefit of a party in interest to the plan. For this purpose, a “party in interest” includes any service provider to the plan and, consequently, ERISA prohibits both the service provider and the fiduciary from entering into a contract or arrangement for the provision of services to the plan, unless an exemption applies. Parallel rules under the Internal Revenue Code of 1986, as amended (the “Code”), can impose severe penalty taxes on the service provider and the plan fiduciary with respect to transactions prohibited by ERISA, unless an exemption applies.

ERISA broadly exempts from the prohibited transaction rules of ERISA the “contracting or making reasonable arrangements for . . . services necessary for the establishment or operation of the plan”, so long as reasonable compensation is paid for such services and the transaction does not otherwise involve a conflict of interest or self-dealing by the fiduciary causing the plan to enter the transaction (the “Responsible Plan Fiduciary”). The Code contains a parallel exemption which provides relief from the penalty taxes that might otherwise apply to such transactions. Both service providers to employee benefit plans and their fiduciaries commonly rely on this statutory exemption, without which most services provided to plans would be prohibited by ERISA and subject to the penalty taxes under the comparable provisions of Code. As a consequence, it is expected that the Interim Final Regulations will apply broadly within the pension services industry.

Under the Interim Final Regulations, no contract or arrangement for services between a Covered Plan and a Covered Service Provider (each as defined below) will be “reasonable” within the meaning of the statutory exemption unless the disclosure requirements of the Interim Final Regulations have been satisfied. In addition, a Responsible Plan Fiduciary who reasonably relies on information disclosed by a service provider, and otherwise complies with the Interim Final Regulations, is exempted from the prohibited transaction rules of ERISA.

COVERED PLAN AND COVERED SERVICE PROVIDER

As discussed above, the disclosure requirements of the Interim Final Regulations apply with respect to a Covered Service Provider of a Covered Plan (as defined below).

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Covered Plan. A Covered Plan is defined as an “employee benefit pension plan” as defined in ERISA, which generally includes pension plans, 401(k) plans and similar arrangements. The regulation expressly excludes (1) governmental plans, church plans and foreign plans and (2) simplified employee pensions (Code Section 408(k)), simplified retirement accounts (Code Section 408(p)), individual retirement accounts (Code Section 408(a)) and individual retirement annuities (Code Section 408(b)). The Interim Final Regulations do not apply to health, medical, disability or vacation plans, or other similar plans and arrangements, which are specifically reserved for future regulation.

Covered Service Provider. A Covered Service Provider is defined as a service provider entering into a contract or arrangement with a Covered Plan to provide one or more of the following services:

- **Direct Fiduciary Services.** Services provided directly to the Covered Plan as a fiduciary or as an investment advisor registered under the Investment Advisors Act or any State law (an “Investment Advisor”);
- **Fiduciary Services to Plan Assets Vehicle.** Services provided by an ERISA Fiduciary to an investment contract, product or entity that holds plan assets as determined under ERISA and the regulations thereunder (a “Plan Assets Vehicle”);
- **Certain Services as a Platform Provider.** Recordkeeping or brokerage services to participant directed individual account plans (such as a 401(k) plan), if one or more investment alternatives are made available to plan participants in connection with such services (a “Designated Investment Alternative”);
- **Indirect Compensation Services.** Most other services provided to the Covered Plan for which the Covered Service Provider expects to receive compensation from persons other than the Covered Plan (“Indirect Compensation”), including compensation from parties related to the Covered Service Provider.

A Covered Service Provider expressly does not include a person or entity (1) solely providing services as an affiliate or subcontractor of a Covered Service Provider or (2) providing non-fiduciary services to a Plan Assets Vehicle.

Thus, for example, the disclosure requirements of the Interim Final Regulations will apply to asset managers, investment advisors and other fiduciaries employed directly by the Covered Plan (or by an entity whose assets include the assets of a Covered Plan as determined under ERISA and the regulations thereunder), and to service providers who provide the investment platform for a 401(k) plan, but will not apply with respect to other service providers (e.g., accountants, custodians, lawyers and so forth) unless such service providers receive Indirect Compensation.

De Minimis Exception. A service provider will not be a Covered Service Provider if the service provider reasonably expects to earn less than $1,000 in connection with providing services to the plan.

**GENERAL DISCLOSURE REQUIREMENTS**

Reasonably in advance of entering into a contract or arrangement for the provision of services, a Covered Service Provider must disclose to the Responsible Plan Fiduciary in writing the following information.
Services/Status. Description of the services to be provided and, if applicable, a written statement that the Covered Service Provider (or an affiliate or subcontractor) will provide (or reasonably expects to provide) services as an ERISA Fiduciary or as an Investment Advisor.

Compensation. Description of all compensation expected to be received by the Covered Service Provider, an affiliate or an independent contractor (1) directly from the Covered Plan (“Direct Compensation”) (either in the aggregate or by service), (2) from persons other than the Covered Plan (i.e., Indirect Compensation) and a description of the payors of such compensation, (3) from the Covered Service Provider, its affiliates or a subcontractor, if set on a transaction basis or directly charged against the Covered Plan’s investment and reflected in net asset value, and a description of the services for which such compensation will be paid and the payors/recipient of such compensation. In addition, a description of termination fees and the manner of refunding prepaid amounts must be provided.

Recordkeeping Services. Without regard to the foregoing items of disclosure, a description of all direct and indirect compensation for recordkeeping services; and if recordkeeping services are expected to be provided without explicit compensation or rebated or offset based on other compensation, a reasonable and good faith estimate of the cost of providing such services and the methodology for providing the estimate.

The disclosure obligations apply whether or not the contract or arrangement is in written form. For contracts and arrangements entered into prior to July 16, 2011, the same information must be provided before July 16, 2011. The Covered Service Provider must also disclose in writing whether the Covered Plan will be billed directly for the services or whether compensation will be deducted from the plan’s accounts or investments.

The disclosures required by the Interim Final Regulations must be made reasonably in advance of entering into a contract or arrangement for providing services or, if later, not later than 30 days after the Covered Service Provider learns that an investment contract, product or entity to which it provides fiduciary services is a Plan Asset Vehicle. Changes to the information disclosed generally must be disclosed within 60 days of the change.

No contract or arrangement will fail to be “reasonable” under the regulation solely because the Covered Service Provider, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the information required by the regulation. However, the Covered Service Provider must disclose the correct information as soon as practicable, but not later than 30 days from the date on which the Covered Service Provider knows of such error or omission.

DISCLOSURE REQUIREMENTS FOR PLAN ASSETS VEHICLES AND PARTICIPANT DIRECTED ACCOUNT PLANS

An ERISA Fiduciary of a Plan Assets Vehicle must also provide to the Responsible Plan Fiduciary a written description of any compensation that will be charged directly against the amount invested by the Covered Plan in a Plan Assets Vehicle (e.g., sales loads, exchange fees, etc.), the annual operating expenses (if the return is not fixed) of the Plan Assets Vehicle, and any additional ongoing expenses (e.g., wrap fees, mortality and expense fees).
The same information must be provided to the Responsible Plan Fiduciary with respect to each Designated Investment Alternative of a participant directed individual account plan for which brokerage or recordkeeping services will be provided. This requirement can be satisfied by delivering the disclosure materials of the issuer of the Designated Investment Alternative (if containing the required information), provided the issuer is not an affiliate of the Covered Service Provider, the disclosure materials are regulated by a State or federal agency and the Covered Service Provider does not know the materials are incomplete or inaccurate. When adding a new Designated Investment Alternative, these disclosures must be provided before the Covered Service Provider includes the new alternative in the investment platform.

EXEMPTION FOR RESPONSIBLE PLAN FIDUCIARY

As discussed above, the Interim Final Regulations also include an exemption for the Responsible Plan Fiduciary.

Under the exemption, the Responsible Plan Fiduciary generally will not be subject to the prohibited transaction rules of ERISA (so long as the transaction does not otherwise involve a conflict of interest or self-dealing by the fiduciary) on account of a failure by the Covered Service Provider to provide the information required by the Interim Final Regulations so long as: (1) the Responsible Plan Fiduciary did not know the Covered Service Provider failed or would fail to provide the required information and reasonably believed that the Covered Service Provider made proper disclosures; (2) upon learning of any such failure, the Responsible Plan Fiduciary requires in writing that the proper disclosure be provided; and (3) if the failure continues following the request, the fiduciary so notifies the Department of Labor no later than the earlier of 30 days following the Covered Service Provider’s refusal to provide the information or 90 days after the fiduciary makes the written request.

Thus, although the Interim Final Regulations primarily impose disclosure obligations on Covered Service Providers (and not on the Responsible Plan Fiduciary), in order to ensure qualification under the exemption, a Responsible Plan Fiduciary should require its service providers to provide the appropriate disclosures and should review such disclosures for any obvious errors or omissions, and should generally be aware of changes to the contract or arrangement that might require additional disclosure (such as the designation of a new investment alternative under a 401(k) Plan).

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ENDNOTES

1  In other words, “welfare benefit plans” as defined in Section 3(1) of ERISA.
2  Section 408(b)(2) of ERISA and the regulations thereunder.
3  The exemption contained in the Interim Final Regulations provides relief from transactions.
4  In other words, “welfare benefit plans” as defined in Section 3(1) of ERISA.
5  “Fiduciary” is defined for this purpose as any person with discretionary authority or control with respect to the assets or management of the plan or any person who provides investment advice to the plan for a fee or other direct or indirect compensation.
6  More specifically, a Designated Investment Alternative is any investment designated by a fiduciary into which participants and beneficiaries may direct the investment of their individual accounts, but does not include brokerage windows, self-directed accounts or similar arrangements that enable the selection of investments beyond those specifically designated.
7  Accounting, auditing, actuarial, appraisal, banking, consulting, custodial, insurance, investment advisory, legal, recordkeeping, securities or other investment brokerage, administration and valuation services.
8  E.g., commissions, soft dollars, finder’s fees, etc.
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