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Management Alert

DOL Proposes New Fee Disclosure Rules for 401(k) Plans

The Department of Labor (DOL) has issued a new proposed regulation that would require the disclosure of fee and expense information to participants in participant-directed individual account plans such as 401(k) plans. If adopted in its current form, the proposed regulation would take effect in 2009.

The new fee disclosure regulation is the last installment in a three-part series of new regulations dealing with fee and expense disclosure rules for qualified retirement plans. The first two sets of regulations were:

- a final regulation requiring additional Form 5500 disclosure of compensation paid to service providers, effective for plan years beginning on or after January 1, 2009; and
- a proposed regulation requiring service providers to disclose the details of their compensation to the plan, including compensation received from third parties, which could impose liability on plan fiduciaries who fail to obtain the required disclosures.

The latest proposed regulation establishes uniform fiduciary disclosure requirements for all participant-directed individual account plans, which must be provided on or before the date the participant becomes eligible to participate in the plan and thereafter on a periodic, ongoing basis. The information required falls into two categories: plan-related information and investment-related information.

Plan-Related Information

General plan-related information includes several familiar disclosures, including:

- how to give investment instructions,
- limitations on investment instructions,
- exercise of voting and other shareholder rights, and restrictions on investments and investment alternatives,
- designated investment alternatives offered under the plan, and
- identification of any designated investment managers to whom participants and beneficiaries may give investment elections.

In addition, the proposed regulation would require that a participant receive (at the time of eligibility to participate in the plan and at least annually thereafter) an explanation of any fees and expenses for plan administrative services that may be charged to the plan and the basis (per capita or pro rata) on which the charges will be allocated

to, or affect the balance of, each individual participant account. Plan expenses include legal, accounting, and recordkeeping services. The explanation may be disclosed in the plan's summary plan description. At least quarterly, participants must also receive a statement of the dollar amount actually charged to their account for administrative services and a general description of the services provided for the charge. The administrative expenses may be disclosed on an aggregate or summary basis; thus, the disclosure may provide a single amount for recordkeeping, accounting and legal services. The quarterly fee disclosure may be included on the quarterly benefit statement.

Under the proposed regulation, participants must also receive disclosure of amounts assessed against their account on an individual basis, such as fees related to QDROs, participant loans, and investment advisory services. An explanation of the individual fees that may be charged to a participant's account must be disclosed at the time of eligibility and at least annually thereafter, and the actual amount of individual expenses charged to a participant's account must be disclosed quarterly (and may be included in the quarterly benefit statement).

Investment-Related Information

Investment-related information must be provided automatically to each participant for each investment option offered under the plan (other than arrangements that enable participants to select investments outside of those selected by the plan, such as self-directed brokerage accounts and brokerage windows) and includes:

- name and category of the investment alternative,
- Internet web site address for additional information regarding the investment alternative,
- average annual total return on the investment for one-, five-, and 10-year periods,
- performance data for "an appropriate broad-based benchmark" over the same or comparable time periods, and
- fees and expenses related to the purchase, holding and sale of an investment alternative (shareholder fees such as sales loads, sales charges, and redemption fees and the alternative's expense ratio).

Investment-related disclosures must be provided to each participant on or before the date of plan eligibility and at least annually thereafter. The disclosure requirement may be satisfied by providing the participant with the most recent annual disclosure for the investment.

Other investment-related information must be provided subsequent to the particular investment (information primarily related to pass-through voting rights) or upon request by the participant (both disclosure requirements are similar to the current ERISA Section 404(c) requirements).

Proposed Amendment to 404(c) Regulations

Many of the disclosures that will now be mandatory for all participant-directed plans were already part of the safe harbor provided under ERISA Section 404(c), which provides protection for plan fiduciaries from liability for the results of participants' investment decisions if the plan complies with the Section 404(c) regulations. Accordingly, the proposed regulations would also amend the Section 404(c) regulations so that compliance with the new mandatory disclosure regulations will automatically satisfy the disclosure requirements of Section 404(c).

One welcome change made by the proposed fee disclosure regulation is the elimination of the requirement currently contained in the Section 404(c) regulations that a plan automatically furnish each participant with a copy of a mutual fund's current prospectus the first time a participant invests in the fund, rather than simply making the prospectus available through a website or upon request.

However, plan fiduciaries will still have to comply with the remaining requirements of Section 404(c) in order to receive the protection of the safe harbor. Moreover, the DOL also used the proposed fee disclosure regulation as an opportunity to formalize its interpretation that Section 404(c) does not extend relief to a fiduciary's duty to prudently select and monitor investment funds under the plan, an interpretation on which the courts are currently split and that is now pending before the Court of Appeals for the Seventh Circuit.

The first two installments of the DOL's fee disclosure regulations are summarized below.

Form 5500 Schedule C Fee Disclosure

Under the new final rule on Form 5500 disclosure (issued on November 16, 2007), for plan years beginning on or after January 1, 2009, large plans with 100 or more participants must report as compensation on Schedule C money and other things of value (including gifts, awards, trips, Rule 12b-1 fees, finder's fees, brokerage commissions and fees, soft-dollar payments, account management fees, shareholder servicing fees, and float income) that service providers receive directly or indirectly from the plan or a third party for services to the plan. The final rule defines "service provider" and includes persons and entities who receive direct and indirect compensation from the plan or a third party, as well as persons and entities who provide services directly or indirectly for the plan. Thus, the new rule may include persons who are not "parties in interest" under ERISA.

Previously, large plans were required to disclose only fees paid to the plan's 40 highest-paid service providers. The new rule requires that payments be disclosed on Schedule C if the service provider receives, directly or indirectly, $5,000 or more in reportable compensation for a particular transaction or service to the plan. If a service provider receives indirect compensation from multiple plans, the plan administrator may then use the service provider's allocation method in determining the fees attributable to the individual plan being reported.

The new rule now requires plan administrators to identify plan fiduciaries and certain enumerated plan service providers receiving, directly or indirectly, compensation for services to the plan of more than $1,000 or more from a single source other than the plan or plan sponsor. The "enumerated plan service providers" requirement is limited to those arrangements that are more likely to present conflict-of-interest concerns and may include: contract administrators, securities brokerage, insurance brokerage/agent, custodial, consulting, investment advisory, investment or money management, recordkeeping, trustee, appraisal, or investment evaluation. The new rule requires the following information for enumerated plan service providers: the (1) payor of such indirect compensation, (2) payor's relationship with the plan or services provided to the plan by the payor, (3) amount paid, and (4) nature of the compensation. It is unclear from the new rule what standard a plan sponsor should use in determining which compensation arrangements with enumerated service providers are more likely to present conflict-of-interest issues.

If a plan utilizes a bundled service arrangement, the individual services need not be disclosed; however, a person or other provider in the bundled arrangement that receives separate fees from the plan must be reported, along with a fiduciary who receives $5,000 or more in reportable income for services to the plan.

Disclosure of Compensation Received by Service Providers

The final proposed regulation (issued on December 17, 2007) adds new disclosure requirements for compensation received by plan service providers, either from the plan or from third parties dealing with the plan. The disclosure requirements apply to retirement and health and welfare plans. Under the proposed regulation, direct and indirect compensation received by certain plan service providers and potential conflicts of interest must be disclosed. The disclosure requirements apply to service providers that:

1) provide services to plans as a fiduciary under ERISA or the Investment Advisers Act of 1940,
2) supply banking, consulting, custodial, insurance, investment advisory, investment management, recordkeeping, securities and investment brokerage, or third-party administrative services, and
3) receive indirect compensation in connection with accounting, actuarial, appraisal, auditing, legal, or valuation services.

The proposed regulation requires that all such service provider contracts or arrangements be in writing and contain specified disclosures of the payment arrangements, relationships, and compliance processes.

The proposed regulation also requires that the service provider notify the plan fiduciary of any changes in the required disclosures and provide timely information for the plan's Form 5500 filing.

Failure to meet the new disclosure requirements would result in a prohibited transaction, subjecting the plan fiduciary and the service provider to penalties and excise taxes. However, the DOL has proposed some relief for the plan fiduciary where a service provider fails to satisfy its disclosure obligations in the form of a proposed Class Exemption to the prohibited transaction rules. To meet the exemption, the plan fiduciary must notify the service provider upon discovery of its failure to satisfy disclosure obligations, request the information needed in writing, and report such failure to the DOL if the service provider fails to comply with the plan fiduciary's request within 90 days. The plan fiduciary should also consider the circumstances of the failure to comply and determine whether to retain the service provider.

This proposed regulation, once finalized, will require significant changes to many service provider agreements and arrangements to ensure compliance. The regulation is proposed to be effective 90 days after it is finalized, but the DOL has solicited comments on whether a longer transition period is required to enable plans and service providers to amend their agreements.

If you have any questions about the final or proposed retirement plan fee and expense disclosure regulations, or any other employee benefit matter, please contact your Seyfarth Shaw attorney or any other Seyfarth Shaw attorney on our website (www.seyfarth.com/EmployeeBenefits).

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