



April 2012

PENSION ANALYST

Important information — Plan administration and operation



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DOL issues final service provider fee disclosure rules

Who's affected

This guidance applies to sponsors of defined benefit and defined contribution pension plans (including 403(b) plans) that are subject to ERISA, referred to collectively as “covered plans”. It does not apply to governmental plans, church plans that do not elect to be covered by ERISA (“nonelecting church plans”), non-ERISA 403(b) plans, and unfunded excess benefit plans.

Background and summary

On February 3, 2012, the Department of Labor (DOL) issued long-awaited final rules requiring certain service providers to disclose fee information to fiduciaries of covered plans.

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 ensure plan fiduciaries have complete and accurate information to fulfill these responsibilities, and to clarify the conditions of the statutory prohibited transaction exemption that permits the provision of necessary services for no more than reasonable compensation, the DOL issued these final regulations.

The final rules generally adopt the guidance provided in the [interim final rules](#), but do include the following revisions:

- A change in the “covered plans” definition to exclude certain section 403(b) annuity contracts and custodial accounts;
- A revision in the “indirect compensation” disclosure rules to require a description of the arrangement between the payer and the service provider;
- A change in the “compensation” definition to allow a reasonable good faith estimate of compensation if this information is not readily available; and
- A change in the timing of disclosures relating to investment changes.

The final regulations also extend the deadline for complying with the service provider fee disclosure rules by three months, to July 1, 2012. In turn, the effective date for the [participant-level fee disclosure rules](#) applicable to certain defined contribution plans has been extended to August 30, 2012 for calendar year plans.

Action and next steps

Prudential Retirement has, for many years, issued fee disclosure information to assist plan fiduciaries with their obligations. With the publication of the final regulations, we are updating our disclosures solutions to fully comply with the final rules by the revised compliance deadline. While these rules require service providers to timely provide disclosures to covered plans, plan fiduciaries must use that information to fulfill their fiduciary duties to select and monitor service providers and investments in the best interest of plan participants. Administrators and fiduciaries of covered plans should read this publication to familiarize themselves with the final regulations.

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The furnishing of goods, services, or facilities between a plan and a party in interest to the plan is generally a prohibited transaction under ERISA. Since any person providing services to a plan is defined by ERISA to be a “party in interest,” the relationship between a service provider and a plan would be considered a prohibited transaction, unless an exemption is provided. In fact, ERISA does provide a prohibited transaction exemption for plan service arrangements if all of the following conditions are met:

- The contract or arrangement between a service provider and plan is reasonable;
- The services are necessary for the establishment or operation of the plan; and
- No more than reasonable compensation is paid for the services.

It is the third requirement, that compensation paid by the plan for services rendered by a service provider be reasonable, which gives rise to the new fee disclosure rules. The final rules now clarify a number of terms and concepts introduced in the [July 2010 interim final rules](#).

Covered plans

The DOL regulations generally require service providers to provide fee disclosures to defined benefit and defined contribution plans (including 403(b)) plans that are subject to ERISA, which are referred to as “covered plans.”

The final rules modify the interim rules by providing that frozen 403(b) annuity contracts or custodial accounts that are subject to ERISA will not be considered covered plans and are not subject to the fee disclosure rules, if:

- The plan sponsor had no obligation to make, and did not make contributions (including employee salary reduction contributions) to such contracts or custodial accounts after January 1, 2009;
- The contract or account was issued to a current or former employee before January 1, 2009;
- All rights and benefits under the contract or custodial account are legally enforceable against the insurer or custodian by the individual owner of the contract or account without any employer involvement; and
- The individual owner is fully vested in the contract or account.

Covered service providers

The final rules did not change the definition of covered service providers. Covered service providers are those providers, such as Prudential Retirement, that reasonably expect to receive \$1,000 or more in [direct](#) or [indirect](#) compensation for providing one or more of the following:

- Services as a fiduciary either directly to a covered plan or to an investment vehicle that holds ERISA “plan assets;”
- Services as a registered investment advisor;
- Recordkeeping or brokerage services provided directly to participant-directed defined contribution plans, if one or more designated investment alternatives will be made available through a platform or similar mechanism in connection with the services; or
- Services for which the service provider reasonably expects to receive indirect compensation, including accounting, auditing, actuarial, appraisal, banking, consulting related to the development or implementation of investment policies or objectives, consulting related to the selection or monitoring of service providers or plan investments, custodial, insurance, investment advice (plan sponsor or participant level), legal, recordkeeping, securities, or other investment brokerage, third party administration or valuation services provided to the plan. If any of these services result only in direct compensation to the service provider, other than recordkeeping or brokerage services provided to a participant-directed defined contribution plan, they are not required to be disclosed.

For example, a third party administrator provides a defined benefit plan with administrative services, such as nondiscrimination testing and recordkeeping. The third party administrator receives all of its compensation through direct payment from the defined benefit plan. It is not indirectly compensated. Therefore, the third party administrator is not a covered service provider.

An affiliate or subcontractor of a covered service provider is not considered a covered service provider.

Compensation

Similar to the interim final rules, the final rules define “direct compensation” as compensation the covered service provider receives directly from the plan, including compensation that is paid directly from participants’ and beneficiaries’ accounts. “Indirect compensation” is compensation received from any source other than the covered plan, the plan sponsor, the covered service provider, or an affiliate. Compensation paid by a subcontractor to a service provider is indirect compensation, unless it is received in connection with services performed under the subcontractor’s contract or arrangement. Compensation paid directly by a plan sponsor to a service provider is not considered to be either direct or indirect compensation and is not reportable.

Compensation may be disclosed as a dollar amount, a formula, a percentage of the covered plan assets, or a per capita charge for each participant or beneficiary. If the compensation cannot reasonably be expressed in one of those manners, another reasonable method may be used. Nonmonetary compensation of \$250 or less over the term of the contract is not included as compensation.

The final regulations also provide that the description of compensation may include a reasonable good faith estimate if the covered service provider cannot readily describe compensation or cost. However, the covered service provider must explain the methodology and assumptions used to prepare the estimate. Any description must contain sufficient information to evaluate the reasonableness of the compensation or cost.

Disclosure requirements

Required disclosures must be in writing, and may be delivered electronically, provided they are readily accessible to plan fiduciaries and fiduciaries are notified how to access the information.

The covered service provider must disclose the following information to a responsible plan fiduciary:

- A description of the services to be provided;
- A statement that the provider will provide any services as a fiduciary or as a registered investment advisor, if applicable;
- A description of all direct compensation, in the aggregate or by service, that the provider expects to receive;
- A description of all indirect compensation that the provider, its affiliates or its subcontractors reasonably expects to receive from third-parties for services provided to the plan. This description must:
 - Identify the services for which the indirect compensation will be received;
 - Identify the payer of the indirect compensation; and
 - Describe the arrangement between the payer and the provider, an affiliate or a subcontractor for which the indirect compensation is paid. This new requirement is intended to provide fiduciaries with information to identify potential conflicts of interest resulting from receipt of indirect compensation.
- A description of the compensation that will be paid for services provided to the plan among the covered service provider, its affiliates, and its subcontractors *only* if the compensation is either:
 - 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
 - Charged directly against the covered plan’s investment and reflected in the net value of the investment (e.g., Rule 12b-1 fees);
- A description of any compensation that the provider its affiliates, or subcontractors reasonably expect to receive in connection with termination of the contract or arrangement, and how any prepaid amounts will be calculated and refunded upon termination;

- If recordkeeping services will be provided to the plan, the provider must also disclose the following information:
 - A description of the direct and indirect compensation the provider, affiliate, or subcontractor reasonably expects to receive for the recordkeeping services; and
 - If all or part of the recordkeeping services will be provided without explicit compensation (i.e., bundled) or if the compensation is offset or rebated based on other compensation received by the provider, affiliate, or subcontractor, a reasonable and good faith estimate of the cost to the plan of the recordkeeping services. This estimate must include an explanation of the methodology and assumptions used to prepare the estimate and a detailed explanation of the recordkeeping services that will be provided to the plan.
- A description of the manner in which the compensation will be received, such as whether the plan will be billed or whether the compensation will be deducted directly from plan accounts or investments;
- Fiduciaries to an investment contract, product, or entity that holds plan assets in which the covered plan has a direct equity investment and recordkeepers to participant-directed defined contribution plans that provide an investment platform must disclose the following information regarding investment products and investment options provided to the plan:
 - A description of any compensation that will be charged directly against the amount invested in connection with its acquisition, sale, transfer of, or withdrawal from the investment contract, product, or entity (e.g., commissions, sales loads, sales charges, deferred sales charges, redemption fees, surrender charges, exchange fees, account fees and purchase fees);
 - A description of the annual operating expenses (e.g., expense ratio) if the return is not fixed;
 - A description of any ongoing expenses in addition to annual operating expenses (e.g., wrap fees, mortality and expense fees);
 - A description of the total annual operating expenses expressed as a percentage and calculated as required by the [participant-level fee disclosure regulations](#); and
 - Any other information or data about a designated investment alternative that is within the control of or reasonably available to the covered service provider that is needed for the plan administrator to comply with the participant-level fee disclosure rules.

In certain situations, covered service providers may distribute the information they receive from investment providers.

Summary or guide to initial disclosures

The regulations allow disclosures to be provided in multiple documents. The final regulations encourage, but do not require, covered service providers to provide a guide, summary, or similar tool to assist fiduciaries in identifying all of the disclosures required under the final regulations. The DOL intends to request comments in the future regarding a potential *requirement* to provide such a summary and how to cost effectively structure a guide or similar requirement.

Disclosure timing

Disclosures must be provided to the responsible plan fiduciary reasonably in advance of the date the contract or arrangement is entered into, extended or renewed.

Changes to required information must be disclosed not later than 60 days from the date on which the covered service provider is informed of such change. If disclosure is not possible due to circumstances beyond the control of the provider, the information must be disclosed as soon as possible. The 60-day timing requirement is limited to information concerning the:

- Services to be provided;
- Status of the provider, an affiliate or subcontractor as an ERISA fiduciary or registered investment adviser;
- Compensation to be received in connection with the contract or arrangement;
- Cost of recordkeeping services; and
- Manner of receipt of compensation.

However, the final rules provide an alternate timing standard for changes to information regarding investment products and investment options provided to the plan. Rather than providing notification within 60 days, changes to required investment information must only be disclosed annually.

Upon written request from the responsible plan fiduciary or covered plan administrator, a covered service provider must also provide any other information required for the plan to comply with the reporting and disclosure requirements of ERISA, including information necessary for Form 5500, Schedule C. The final rules revise the timing requirement and now require that this information be furnished reasonably in advance of the date upon which the fiduciary or plan administrator states that it must comply with the applicable reporting or disclosure requirements. If the provider cannot provide such information due to circumstances beyond its control, it must provide the information as soon as possible.

Relief for covered service providers

If a covered service provider makes an error or omission when disclosing the required information, the provider will have an opportunity to avoid a prohibited transaction. To obtain this relief, the service provider must disclose the correct information as soon as practicable, but no later than 30 days from the date the provider discovers the error.

Relief for responsible plan fiduciaries

Similar to previous guidance, the final rules also include relief to protect responsible plan fiduciaries from engaging in a prohibited transaction in the event a covered service provider fails to disclose the required information. To be eligible for the relief, all of the following conditions must be met:

- The fiduciary did not know the provider failed to disclose the required information and reasonably believed the required information was disclosed;
- Upon discovering the failure, the fiduciary makes a written request to the provider to provide the information; and
- If the provider fails to comply with the fiduciary's written request within 90 days of the request, the fiduciary must notify the DOL of the provider's failure. The notification to the DOL must occur no later than 30 days following the earlier of:
 - The service provider's refusal to provide the requested information; or
 - 90 days after the written request to the service provider is made.

The final rules modify previous guidance when the requested information relates to future services (i.e., services that will be performed after the end of the [90-day](#) period). If the information is not disclosed promptly after the end of this 90-day period, the responsible plan fiduciary must terminate the contract or arrangement as soon as possible, to comply with the requirement that fiduciaries act prudently.

The DOL has provided a [sample notice](#) that plan fiduciaries may use to notify the DOL of a service provider failure to timely provide required disclosures.

Effective date and next steps

These final rules are effective July 1, 2012 (extended from April 1, 2012). This new effective date also affects when disclosures must first be furnished under the DOL's participant-level fee disclosure regulations. For calendar year plans, the initial annual participant-level fee disclosures must be furnished no later than August 30, 2012 (i.e., 60 days after the effective date of fee disclosure rules) and the first quarterly statement must be furnished no later than November 14, 2012.

Prudential Retirement has been taking steps for a number of years to ensure that plan sponsors receive the important disclosures the final rules now require of all covered service providers. We have modified the disclosures issued in prior years to comply with the final rules and effective dates. We have developed a number of tools and resources to help our clients understand these regulations and our solutions. Our plan sponsor user's guide provides an overview of our disclosure documents and delivery processes and will offer practical assistance for using the updated disclosure solutions we will issue to impacted plans this summer.

Pension Analyst by Prudential Retirement

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