The Department of Labor published interim final regulations on service provider fee disclosure on July 16, 2010. These regulations amend existing rules under section 408(b)(2) of the Employee Retirement Income Security Act of 1974 (ERISA) and parallel provisions of section 4975(d)(2) of the Internal Revenue Code and regulations thereunder.

Background
Under ERISA section 406(a)(1)(C), a service arrangement between a plan and a service provider (party-in-interest) would generally constitute a prohibited transaction. However, ERISA section 408(b)(2) provides an exemption from ERISA’s prohibited transaction rules if the service arrangement is reasonable, the services are necessary for the establishment and operation of the plan and no more than reasonable compensation is paid for the services.

In December 2007, the DOL published proposed regulations under ERISA section 408(b)(2) and a proposed class exemption from ERISA’s prohibited transaction rules. The proposed regulations required that in order for a service arrangement to be reasonable it must include certain disclosure information about the services to be provided by the service provider and the fees to be charged for such services. The information was necessary to (i) assist plan fiduciaries in assessing the reasonableness of the compensation paid for services provided under the service arrangement and (ii) identify conflicts of interest that may affect the service provider’s performance of services. In addition, the proposed regulations were designed to assist plan fiduciaries in obtaining the information they need from service providers to satisfy their reporting and disclosure obligations under ERISA.

The interim final regulations contain some significant changes from the 2007 proposed regulations, but retain the basic structure of the proposed regulations by continuing to require that certain service providers satisfy disclosure requirements in order to qualify for the ERISA section 408(b)(2) exemption. While the interim final regulations have the full effect of law, they may be subject to change after the DOL receives public comments. The comment period ends on August 30, 2010.

Arrangements Not Covered by Interim Final Regulations
Arrangements that fall outside the scope of the interim final regulations must still meet ERISA’s reasonableness requirements and plan fiduciaries have an obligation to obtain and carefully consider information necessary to assess the services to be provided to the plan, the reasonableness of the compensation and expenses being paid for the services as well as potential conflicts of interest that may affect the quality of the services.

Effective Date
The interim final regulations are effective July 16, 2011 and apply to all service arrangements in existence on that date as well as those entered into on and after that date. For service arrangements entered into prior to July 16, 2011, the required disclosure information must be furnished no later than July 16, 2011. Service providers and plan fiduciaries not in compliance as of July 16, 2011 will be subject to ERISA’s prohibited transaction rules and the applicable excise taxes under the Internal Revenue Code.

Covered Plans
The new disclosures under the interim final regulations apply to defined contribution and defined benefit plans subject to ERISA.
Simplified Employee Pensions (SEPs), SIMPLEs, IRAs and non-ERISA plans are not covered plans for purposes of the interim final regulations. Welfare benefit plans are not covered, but the DOL expressed its intent to issue guidance on these plans in the future.

**Covered Service Providers**

The interim final regulations include 3 main categories of "covered service providers" and apply only to those service providers expected to receive at least $1,000 in direct or indirect compensation during the term of a service arrangement. Only the service provider that is a party to the service arrangement with the covered plan is a covered service provider (not its affiliates or subcontractors).

- **ERISA Fiduciaries or Registered Investment Advisers**
  - There are three subcategories of covered service providers under this category.
    - **ERISA fiduciaries providing services directly to the covered plan**
    - **ERISA fiduciaries providing services to an investment contract, product or entity that holds plan assets (rather than providing services directly to the covered plan) and in which the covered plan has a direct equity investment. The interim final regulations make clear that a direct equity investment does not include investments made by the investment contract, product, or entity in which the covered plan invests.**
    - **Investment advisers registered under either the Investment Advisers Act of 1940 or State law providing services directly to the covered plan.**

- **Providers of Recordkeeping Services or Brokerage Services**
  - This category includes service providers who provide recordkeeping or brokerage services to a covered plan that is a participant-directed individual account plan and which makes designated investment alternatives available as part of their services through a platform or similar mechanism. Brokerage windows, self-directed brokerage accounts and similar arrangements are not designated investment alternatives.

- **Other Service Providers Receiving Indirect Compensation**
  - Covered service providers under this category include those service providers (or their affiliates or subcontractors) reasonably expected to receive indirect compensation or certain payments from related parties for accounting, auditing, actuarial, appraisal, banking, consulting (relating to the development or implementation of investment policies or objectives or the selection or monitoring of service providers or plan investments), custodial, insurance, investment advisory (for the plan or participants), legal, recordkeeping, securities, investment brokerage, third party administration or valuation services for the covered plan. This category includes unregistered investment advisers to the extent they expect to receive indirect compensation.

**Initial Disclosure Requirements - Services and Compensation**

To help ensure that both the plan fiduciary of a covered plan and the covered service provider clearly understand their respective responsibilities for purposes of the ERISA section 408(b)(2) exemption, the interim final regulations require the covered service provider's disclosure to be in writing. No specific format is required at this time. While the DOL is persuaded that plan fiduciaries may benefit from increased uniformity in the format of the disclosure, the DOL does not want to unnecessarily increase the cost and burden to service providers (which cost could in turn be passed on to participants). If the DOL is convinced that the benefits to plan fiduciaries of requiring specific standards for the format outweigh the costs and burden, the interim final regulations may be revised.

A covered service provider must provide the following information to a plan fiduciary of a covered plan:

- A description of the services to be provided
- If applicable, a statement that the covered service provider will, or reasonably expects to, provide services as a fiduciary or as a registered investment adviser, or both
- A description of the compensation (including direct and indirect compensation described below) reasonably expected to be received by the covered service provider, an affiliate, or a subcontractor
during the term of the service arrangement. Non-monetary gifts of $250 or less, in the aggregate, are excluded. Compensation directly paid by a plan sponsor is not covered by the interim final regulations.

- **Direct Compensation** is compensation received directly from the covered plan.
- Compensation may be disclosed as a dollar amount, by formula, a percentage of plan assets, a per capita charge, or, if not easily expressed in those terms, any reasonable method that permits a plan fiduciary to evaluate reasonableness of the compensation. There is no requirement to unbundle compensation, except compensation for recordkeeping services. Compensation may be disclosed in the aggregate or by service performed.
- Indirect compensation is compensation received from any source other than the covered plan, the plan sponsor, the covered service provider, an affiliate, or a subcontractor (for compensation received by the subcontractor from the covered service provider under the service arrangement). Disclosure must include identification of the services for which indirect compensation will be received and the party responsible for paying.
- Compensation paid among related parties (the covered service provider, its affiliates and subcontractors). The covered service provider is required to separately disclose such compensation if set on a transaction basis (e.g. commissions, soft dollars, finder's fees or other similar incentive type compensation) or charged directly against the covered plan’s investments and reflected in the net value of the investment, such as 12b-1 fees. In addition, the manner in which compensation will be paid must be disclosed. Further, the services for which compensation will be paid, the payers and recipients of such compensation and the status of each payer or recipient must be identified by the covered service provider. This additional disclosure requirement replaced the lengthy and confusing conflicts of interest statement required in the 2007 proposed regulations.
- A description of the compensation reasonably expected to be paid for termination of the service arrangement and how prepaid amounts will be calculated and refunded upon such termination.

**Manner of Receipt of Compensation**

A description of how the compensation will be received, such as whether the covered plan will be billed or compensation will be deducted directly from the covered plan’s accounts or investments.

- **Investment Disclosure – When Fiduciary Services Will Be Provided**
  
  The following additional information with respect to an investment contract, product or entity that holds plan assets and in which the covered plan has a direct equity investment (unless such information is already disclosed with recordkeeping services or brokerage services):
  
  - A description of compensation charged directly against the amount invested (e.g. sales loads, sales charges, deferred sales charges, redemption fees, surrender charges, and exchange, account and purchase fees)
  
  - A description of 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)

- **Recordkeeping Services**
  
  A description of the recordkeeping services to be provided and the direct and indirect compensation the covered service provider (and its affiliates and subcontractors) reasonably expect to receive for recordkeeping services to a covered plan. If there is no explicit compensation for such recordkeeping services, (or when such compensation is offset or rebated based on other compensation received by the covered service provider, affiliate or subcontractor) a reasonable and good faith estimate of compensation for recordkeeping services, including an explanation of the methodology and assumptions used for the estimate (taking into account the rates that would be charged for a similar plan and similar services).

- **Investment Disclosure – When Recordkeeping and Brokerage Services Will Be Provided**
  
  A description of the additional information similar to those required for Investment Disclosure-When Fiduciary Services Will Be Provided, as described above, but with respect to each designated
investment alternative. The covered service provider may satisfy this requirement by providing current disclosure materials of the issuer of the designated investment alternative that includes the additional information required, provided the issuer is not an affiliate, the disclosure materials are regulated by a State or Federal agency and the covered service provider does not have knowledge that such materials are incomplete or inaccurate.

- **Timing of Initial Disclosure/Changes**
  The covered service provider must disclose the required information to the plan fiduciary reasonably in advance of the date the service arrangement is entered into, extended or renewed, with the following exceptions:
  - If an investment contract, product or entity determined not to hold plan assets in which the covered plan has a direct equity investment is subsequently found to hold plan assets, the information must be provided not later than 30 days of the date the covered service provider learns that such investment contract, product or entity holds plan assets; and
  - With respect to an investment alternative not designated at the time the service arrangement is entered into, the information required to be provided under Investment Disclosure – When Recordkeeping and Brokerage Services Will Be Provided, as described above, must be disclosed not later than the date the investment alternative is designated by the plan fiduciary.

Changes must be disclosed as soon as practicable, but not later than 60 days of the date the covered service provider becomes aware of the change.

- **Timing of Reporting and Disclosure**
  Additional information requested by the plan fiduciary or administrator of a covered plan that is necessary to comply with the plan’s reporting and disclosure requirements under ERISA must be provided not later than 30 days of the date of the request.

- **Disclosure Errors/Omissions**
  Under the interim final regulations, a service arrangement will not fail to be reasonable solely because a covered service provider makes an error or omission in its disclosures as long as it acted in good faith and with due diligence and furnishes correct information to the plan fiduciary not later than 30 days of the date the covered service provider is informed of the error or omission.

**Class Exemption for Covered Plan Fiduciary**

The prohibited transaction restrictions of ERISA will not apply to a covered plan fiduciary notwithstanding any failures of a covered service provider to properly disclose required information provided the plan fiduciary relied in good faith, did not have knowledge of the failure and takes quick action to request the information in writing from the covered service provider.

If the covered service provider fails to comply within 90 days of the request, the plan fiduciary must notify the DOL of the failure. The notice must contain certain basic information about the covered plan and covered service provider and must be filed with the DOL not later than 30 days after the covered service provider’s refusal to furnish the requested information, or 90 days after the written request is made, whichever is earlier. The DOL provides a sample notice on its website (click here to see a copy).

Following an incident of failure to disclose by the covered service provider, the plan fiduciary has an obligation to evaluate the service arrangement for purposes of determining if the service arrangement should be terminated or continued.

**Termination of Service Arrangement**

Under the interim final regulations, unless a service arrangement permits termination by the plan on reasonably short notice without penalty to the plan, such an arrangement is not reasonable. Exceptions to this rule include a provision in the service arrangement that reasonably compensates the service provider for loss upon early termination or a minimal fee (no guidelines provided) to allow recoupment of reasonable start-up costs. Note that this requirement, which was in place prior to the issuance of the interim final regulations, remains unchanged.
Preemption of State Law

The interim final regulations do not preempt any State Law that governs disclosures by parties that provide services to covered plans, except to the extent State Law prevents application of the interim final regulations.

Impact on Other Exemptions

Service providers, plan fiduciaries and plan sponsors need to start considering the impact of the interim final regulations on their current service relationships.

The DOL has stated that it has no view on how the interim final regulations impact other existing exemptions. While some service providers may determine that they do not need to comply with the interim final regulations with respect to some aspects of their services because they are able to rely on other exemptions, it is important to note that plan sponsors may demand compliance with the interim final regulations as a condition of doing business with service providers.