



# The Ferenczy Flash

FROM THE LAW OFFICES OF *Ilene H. Ferenczy, LLC*

## *The Latest Word in Employee Benefits . . .*

### **DOL DISCLOSES CURRENT APPROACH TO SERVICE PROVIDER FEE DISCLOSURE**

Those of us who are retirement plan service providers have been anxiously awaiting the Department of Labor's (DOL's) Regulation on fee disclosure. (Those of you who are **not** in this business likely think we're nuts, but you're probably glad we are on the lookout for things that concern your plan!) Well, the Regulation was issued on Thursday, July 15.

We have to warn you at the outset that this is a complex topic, but we will try to give it the usual Flash brevity and clarity. We also want to warn you that the Regulation is very new and quite murky in certain ways, so more information will become available as we learn more about the DOL's intent.

#### **To give a little history...**

The DOL issued a proposed fee disclosure regulation in December 2007, in the waning days of the Bush Administration, but it was never finalized because of the change in Administrations. The Obama Administration let it be known that it wanted to review the proposed regulation before it was finalized. Furthermore, more than 100 practitioners and plan sponsors answered the DOL's call for comments on the proposal, so there was much for the DOL to consider before the regulation was issued in final form.

At the same time, the debate about how to best give plan sponsors information about what their retirement plans cost was expanded from the DOL to Congress. Most recently, Rep. George Miller (D-CA), chair of the House Education and Labor Committee, presented a proposal on the issue for consideration by the House of Representatives as part of the American Jobs and Closing Tax Loopholes Act of 2010. This proposal was eliminated in the Senate as part of finalizing the legislation. Nonetheless, the legislative potential held up the finalizing of the DOL revised regulation, a task in which the DOL has been engaged for the past year or more.

#### **What the Regulation Tries to Do**

The Employee Retirement Income Security Act (ERISA) is the main body of law for employee benefit plans. ERISA requires that, in order for plan-related fees or expenses to be paid from the plan's trust, the fees or expenses (and the contract governing them) must be reasonable. The person or entity responsible for authorizing this fee payment – usually the plan's sponsor, trustee, or administrative committee (which we'll call the "plan officials" for purpose of this Flash) – has a duty as a fiduciary to ensure that the "reasonableness" requirement is met. However, particularly

for participant-directed 401(k) plans with a designated line-up of investment options, it is inordinately difficult to figure out what fees and expenses are being paid by the plan. This is because much of the expense is being taken out of the investment itself and is part of the expense ratio for the investment – along with a bunch of other expenses—and actually reduces the net rate of return of the investment. So, the plan officials and participants never really see an amount being subtracted from the investment to pay for the services rendered. They simply see the net return on the investment.

Even if a service provider is sending the plan sponsor or the plan a bill for services, it is possible that the provider is also receiving compensation out of the plan assets expense ratio. Therefore, the plan officials cannot determine whether the total compensation received is reasonable for the work being done.

Finally, some service providers “bundle” their services. For example, plans retain the services of a financial institution or an insurance company to provide a myriad of recordkeeping, administrative, and investment-related services, but the plan officials have no idea what is being paid for each of these services. As a result, the plan officials cannot fulfill their fiduciary responsibilities to ensure that monies paid by the plan for services are reasonable.

The Regulation, therefore, is directed at having the service providers disclose to the plan officials the expected and actual compensation the provider receives and the services that the provider supplies to the plan for this compensation.

### **What the Regulation Requires**

In general, blunt terms, the Regulation requires people and companies who provide services to the plan to disclose to the plan officials in writing what services they are performing and what compensation they reasonably expect to receive for those services, usually regardless of from where the compensation is coming. At least on its face, the Regulation digs into any of the quiet corners of financial transactions to find where plan money is changing hands, and then requires its disclosure. Furthermore, the annual reporting form for the plan, the Form 5500, requires certain ongoing fee information. The Regulation outlines the rule that the service providers must respond quickly to plan officials’ requests for this information.

### **Timing**

Most of the information must be provided before the contract is entered into, extended, or renewed. If the plan designates an investment line-up from which participants choose how their account should be invested, information about fees received from those designated investments must be provided as soon as possible, but not later than the date on which the investment is designated as part of the line-up.

Generally, if the information changes, the new information must be provided as soon as practicable, but not later than 60 days from the date on which the provider knows about the change.

The Regulation further requires that the service provider give the plan officials information

needed for Form 5500 within 30 days of receiving the officials' request for the data, unless this is not possible due to extraordinary circumstances. In that case, the data has to be provided as soon as possible.

### **What if the Information Is Not Provided?**

If a service provider does not give the plan the required information, the contract with the provider is presumed to be unreasonable. The result of this is that the service provider is deemed to have engaged in a prohibited transaction – that is, a transaction specifically not permitted by ERISA. The penalty for the service provider is a 15% excise tax on the “amount involved” (which should be the fee charged) **plus** the service provider must correct the transaction. Although this is not explicitly stated in the Regulation, it is possible that the only way to correct the transaction is for the service provider to return the compensation he or she received to the plan. So, if you are the provider and you don't comply, the result could be that you become a free service *and* you have to pay the government 15%.

### **Service Providers Ask: Do We Need an Engagement Agreement?**

The proposed regulation actually required that every service provider enter into a written contract with the plan in order to receive compensation. This requirement is no longer part of the rules. However, as discussed above, you do need to put the compensation terms of your agreement in writing. So, our question to you (if you are a service provider) is: *why wouldn't you* have an engagement agreement that properly outlines the services you provide, the cost of those services, and any other contractual details that you believe are important?? A written contract can clarify the terms of a service provider's engagement, manage the client's expectations of the work to be done and the costs involved, and can control the terms of each party's responsibilities and liabilities.

### **Effective Date**

The Regulation is effective on **July 16, 2011**. That is the deadline for providing the necessary disclosure for contracts in place as of that date. So, service providers have a year to get the process going. However, plan sponsors and service providers should be mindful of the 2011 Form 5500 deadline for the plan. If the deadline to file the Form 5500 for the plan is July 31, 2011, the information required by the Regulation may need to be requested and provided much earlier than that if the service provider is to comply with the July 16, 2011 effective date.

**If you have questions or would like assistance with your service provider contract, please call us.**

### **NOTE**

**We Stand Corrected:** In our last Flash, we referred to the legislation that included the pension funding relief as the American Workers, State and Business Relief Act. In fact, Congress actually approved the provisions we discussed in a differently named bill. Therefore, the actual law was the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010. We apologize for the error.

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