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 N A N C Y J . S P E Z I A  
 T I M O T H Y J . M C G R A W  
 A N D R E W W . S T U M P F F<sup>2</sup>  
 D E B O R A H T H O M P S O N

O F C O U N S E L

N A N C Y H . W E L B E R , P . C .  
 A N T H O N Y S . H A R T I I I  
 R I C H A R D L . S A N D E R S O N , J R .  
 M I C K E Y B A R T L E T T

## Status of DOL Fee Disclosure and other Proposals

As we reported last year, the Department of Labor (“DOL”) has recently been active in proposing and issuing new rules governing retirement plans: particularly rules that relate to fees paid to investment advisors and other plan service providers. The purpose of this memorandum is to update you about the current status of this new guidance, and to suggest practical steps to be taken by plan sponsors in response.

### Here is where things currently stand:

#### A. Now Effective

The following rule had already become final by 2009:

1. **New Form 5500 reporting requirement.** The rules and instructions governing Form 5500 Schedule C have been changed to require disclosure of compensation that a service provider receives, “directly or indirectly,” for services to a plan. These new Form 5500 rules are effective for plan years beginning on or after January 1, 2009, although the DOL has provided relief for up to a year in cases where service providers do not have in place the systems necessary to capture and report the required information.

- **What you should do:**

If you haven't done so already, contact plan service providers to make sure they are prepared to provide the compensation information required by the newly revised Schedule C. If a service provider does not have the systems in place to track that information for 2009, the service provider must, under DOL guidance, provide the plan administrator with a statement that "(i) the service provider made a good faith effort to make any necessary recordkeeping and

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information system changes in a timely fashion, and (ii) despite such efforts, the service provider was unable to complete the changes for the 2009 plan year."

**B. Now Pending**

Several important additional rules were issued in "proposed" form at the beginning of this year. As previous new administrations have done, very soon after taking office, the Obama White House issued a memorandum to federal agencies instructing them to suspend processing of any rule that had not yet become final. This moratorium was intended to provide the new administration time to consider pending rules. The status of the following rules is thus now in doubt.

We nonetheless believe it likely that rules similar to these will eventually be made final by DOL in the months and years to come, and that those rules will be at least as restrictive as previously proposed by the Bush administration. More importantly, and regardless of the ultimate resolution at DOL, the steps required in the proposed regulations are helpful (or even essential) in ensuring that a plan sponsor has met its statutory fiduciary duties under ERISA. As we have noted in recent communications, the proposed rules appeared against the current backdrop of dramatically heightened attention to plan fees by plan participants, government agencies and others (attention which has come, in part, in the form of a wave of litigation against plan sponsors).

**For these reasons, we recommend plan sponsors conduct themselves, effectively, as though the following proposed rules were already final:**

- 1. Requirement that plan service providers provide detailed fiduciary disclosures to plan fiduciaries.** Proposed regulations under ERISA Section 408(b)(2) would require service providers such as investment managers, recordkeepers and third party administrators, among others, to disclose the fees they charge to their ERISA plan clients, including "bundled" and revenue sharing arrangements. These proposed regulations also require that arrangements between a plan and a service provider be documented in a written agreement.

**What you should do:**

Contact us to survey your service providers as to their total fee structure, including various transfer payments of which you may not be aware. These forms of "revenue sharing" increase investment costs and decrease participants' and the plan's investment return. As plan fiduciary, you must identify the true cost of operating your plan, and compare that to the true value of services you are receiving. You may find you are overpaying. It's best that you learn that in a process you control, rather than via litigation or a DOL investigation.

- 2. Disclosure requirement for participant-directed plans.** Proposed regulations under ERISA Section 404(a) would require “participant-directed” plans (plans under which participants can select from a menu of investment options) to provide detailed, annual disclosure of information relating to each investment option, including data concerning investment performance and fee loads.

**What you should do:**

Armed with the information on true fees and true investment returns from item 1 above, you should proactively provide this information to plan participants. After your review, you will be optimally operating the plan, and disclosing this information to participants will have many benefits: you will avoid concerns and possible claims, and will enhance employee appreciation of the plan.

- 3. 404(c) and fiduciary compliance review.** (This is in place and is not pending, but relates to the items above.) ERISA Section 404(c) shifts to participants the responsibility for their asset allocation decisions in their 401(k) plan accounts. ERISA Section 404(a) prescribes the duties you retain as plan fiduciary. To achieve the shift of asset-allocation responsibility, a couple dozen document and process requirements must be met. To meet your 404(a) responsibility, you should perform certain reviews, and you should document your fiduciary diligence in various ways. Again, for your protection and also to optimize your plan's operation for participants benefit, we suggest a review of your fiduciary and "404(c)" processes. This is an inexpensive and "painless" ounce of prevention.

**C. On temporary "hold: Exemption for Participant Advice**

Another rule with implications for fee disclosure was issued shortly before the Obama moratorium took effect:

- 1. Regulation concerning investment advice to plan participants.** The DOL published a regulation on January 21 implementing “prohibited transaction” exemptions that permit the provision to participants of investment advice by a fee-based investment advisor under certain circumstances. For example, the regulation exempts investments made pursuant to an “expert-approved” computer model or where the fees received by the investment advisor do not vary depending on the investment election made by the participant. The exemptions require significant disclosure of, among other things, the fees that may be received by the investment advisor.

**What's this about?** Plan participants need investment advice in allocating assets in their plan accounts. The investment-sellers who provide plan investments, especially in "bundled" plan arrangements, generally have an inherent conflict of interest in giving such advice. In

the Pension Protection Act, Congress allowed for a limited exception where participant advice is based on certain models or the advisor's conflict is otherwise precluded. However, some in Congress felt that the proposed regulation failed to adequately protect participants from conflicted advice.

Although this participant-advice regulation had been issued in “final” form, its stated effective date was not until 60 days after publication, and therefore it is also subject to the Obama moratorium.

### **What you should do:**

Nothing. At this time, if an investment person who provides commission-based investments to your plan attempts to provide participant-advice, an ERISA violation likely occurs. The better course: we recommend that you secure advice from your participants on an unconflicted basis. There are various ways of doing this. The result will be fair advice to your participants. And given investment upheavals, participants are more needful than ever of competent, unconflicted advice.

*It is not known what view President Obama's nominee for Secretary of Labor, Hilda Solis, takes of any of these rules, and the new official most directly responsible for employee benefits, the Assistant Secretary for the Employee Benefits Security Administration, has not yet been named by the Obama administration. Nonetheless, as described above, prudent fiduciary practice suggests that plan sponsors would be well-advised to take steps necessary to be in compliance, at minimum, with the Bush fee disclosure proposals.*

### **D. Summary**

- 1. We recommend that you require full disclosure, in writing, from all plan service providers of all forms of compensation, direct and indirect, that they receive from a plan.**
- 2. The aggregate amount of that compensation should be carefully reviewed and monitored by plan fiduciaries to ensure it is reasonable. In the case of participant-directed plans, disclosure should be made to plan participants of the amount and nature of all service provider fees, direct and indirect.**
- 3. To assist with the foregoing, we strongly recommend that plan sponsors retain fee-based, unconflicted, fiduciary investment advisors with respect to selection of the menu of funds. Your advisor should advise on the reasonableness of costs and service in administrative, custodial, and similar arrangements.**

4. **Agreements with all providers should be reviewed, and insurance/bond details confirmed.**
5. **You should confirm compliance with ERISA sections 404(c) and 404(a), for your benefit and to benefit participants.**

While the recent change in administrations has left the precise parameters of DOL guidance for the moment unclear, that should not be viewed by plan sponsors as reducing the urgency of these issues. In fact, market conditions and litigation suggest close monitoring.

**FOR HELP WITH YOUR COMPLIANCE PLAN, CONTACT ONE OF THE FOLLOWING SKA ATTORNEYS:**

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