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Employee Benefits Advisory: Department of Labor Issues Guidance on 401(k) Plan Fees

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On December 13, 2007, the U.S. Department of Labor issued its long-awaited proposed rule on the subject of 401(k) fee disclosures. The Department issued this rule against a backdrop of increased Congressional attention and media scrutiny, and it is likely to be contentious. This advisory explains the key features of the proposed rule.

Entitled "Proposed Regulation Relating to Service Provider Disclosures Under ERISA Section 408(b)(2)," the newly proposed rule follows on the heels of a solicitation by the Department for comments from interested parties relating to what levels of disclosure might be appropriate. The responses to the Department's solicitation were voluminous and fell into two, predictable camps:

- The financial services industry favored a light regulatory touch, arguing that the greater the level of detail, the greater the cost to participants. In their view, as long as a mutual fund load or expense ratio discloses in the aggregate the amount that the participant can expect to be charged, that amount ought not to be further broken down by amounts paid to the various other vendors and service providers.
- In the other camp is consumer groups, who urged a far more explicit and detailed rule. They argue that participants have a right to know exactly how their money is being spent.

While the proposed rule appears at first blush to favor the financial services industry, a closer reading reveals that this is not the case. The proposed rule is in the form of an amendment to the so-called "service provider" exemption from the ERISA prohibited transaction rules. In addition to imposing stringent fiduciary standards, ERISA identifies certain transactions that are barred under all circumstances absent an express statutory or regulatory exemption. Regulatory exemptions may be either "class exemptions" (which cover categories of commonly encountered transactions) or individual exemptions (which, as the name implies, are applied for on a case-by-case basis). Transactions involving service providers are prohibited, but they enjoy the benefit of a statutory exemption where they are provided under a reasonable contract or arrangement. The Department's proposed rule expands upon, and imposes additional disclosure requirements with respect to, this "service provider" exemption, which will require more comprehensive disclosures in written contracts with service providers. There is, as a result, a great deal at stake here, since the failure to provide the necessary written disclosures can trigger a prohibited transaction, with its attendant tax penalties and other liabilities.

Note

On the same day that it issued its proposed fee disclosure rule, the Department of Labor also proposed a class exemption that offers relief to plan fiduciaries who enter into a contract that is not deemed to be "reasonable" because (unknown to the plan fiduciary) the service provider failed to comply with its disclosure obligations. The effect of this class exemption is to shift the compliance burden toward service providers.

The proposed regulation focuses on disclosure of the direct and indirect compensation received by service providers and on potential conflicts that may affect their objectivity. The proposal affects three classes of service providers:

- fiduciary service providers;
- providers of banking, consulting, custodial, insurance, investment advisory or management, recordkeeping, securities brokerage, or third party administration services; and
- providers who receive indirect compensation for accounting, actuarial, appraisal, auditing, legal, or valuation services.

The key feature of the proposed regulation is its newly announced disclosure requirements. Specifically, the proposed rule mandates the following two types of disclosures:

- **Disclosure of Services and Compensation.** The service provider contract must disclose information regarding all services to be performed and all compensation that will be received either directly from the plan or indirectly from parties other than the plan or plan sponsor. The proposal includes special rules for so-called "bundled" arrangements.
- **Disclosure of Conflicts of Interest.** Service providers also must disclose information about relationships or interests that may raise conflicts of interest for the service provider in performing plan services. These include (i) any participation or interest of the service provider in transactions to be entered into by the plan pursuant to the contract, (ii) any material relationships with other parties that may create conflicts of interest, (iii) any compensation the service provider may receive that it can affect without prior approval by an independent fiduciary, and (iv) any policies or procedures in place to address potential conflicts of interest.

The proposal also includes ongoing disclosure obligations relating to material changes and imposes additional reporting and disclosure requirements. Service providers must disclose material changes to information previously furnished within 30 days of the change, and they must disclose compensation or other information related to the contract or arrangement that is requested by the responsible plan fiduciary or plan administrator.

The Department has produced a laudable first effort. By placing these rules under the "service provider" exemption to the prohibited transaction rules, the Department has ensured that they have teeth. As a result, plan fiduciaries should have access to the information they need to carry out their duties. But given the large amounts of money at stake, and the sheer competitiveness of the 401(k) industry, comments on these proposed rules will likely be voluminous and contentious.

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If you have any questions concerning the information discussed in this alert or any other employee benefits topic, please contact one of the attorneys listed below or your primary contact with the firm who can direct you to the right person. We would be delighted to work with you.

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