SEPTEMBER 2010

THE ERISA LAW GROUP, P.A.

ERISA Alert

205 North Tenth Street, Suite 300 · Boise, Idaho 83702
208.342.5522 · 1.866.ERISALAW
www.erisalawgroup.com

Employers Must Address New ERISA Fee Disclosure Regulations

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The Employee Benefits Security Administration ("EBSA") recently published interim final rules regarding service provider fee disclosures to plans. *The regulations are effective July 16, 2011.*

This article discusses several aspects of the new rule; however, the take away point is simple:

> It is critical that employers and plan fiduciaries obtain and review new required information from their service providers. Otherwise, penalties apply and fiduciaries will be breaching their duties to plan participants.

The Reason for Change

EBSA believes that changes in the way services are provided to plans have resulted in increased complexity and made it difficult for plan sponsors and fiduciaries to understand the services for which they are paying. Despite these complexities, ERISA requires that fiduciaries act prudently and solely in the interest of the plan's participants when selecting and monitoring service providers and investments. EBSA states that:

> [f]undamental to a plan fiduciary's ability to discharge these obligations is the availability of information sufficient to enable the plan fiduciary to make informed decisions about the services, the costs, and the service provider.

The failure to comply means prohibited transactions and fiduciary breaches

To this end, the regulations modify existing Department of Labor ("DOL") regulations that address reasonable and necessary services.

The Existing Rules

Generally, the furnishing of services between a plan and any provider of services to a plan will result in a prohibited transaction under ERISA and the Internal Revenue Code. Prohibited transactions result in the automatic imposition of significant taxes and penalties.

There is an exemption from the prohibited transaction rules for contracts or arrangements between a service provider and a plan if no more than reasonable compensation is paid for the services, the services are necessary for the establishment or operation of the plan, the contract or arrangement is reasonable, and the plan may terminate the contract or arrangement without penalty on reasonably short notice.

New ERISA Fee Disclosure Regulations - Continued

The New Requirements

The new regulations expand on the foregoing exemption by clarifying the meaning of "reasonable" contract or arrangement. *In order for service contracts and arrangements between a "covered plan" and a "covered service provider" to be considered reasonable, the service provider must disclose specified information to a "responsible plan fiduciary."* A responsible plan fiduciary is a fiduciary with authority to cause the plan to enter into, extend, or renew a contract or arrangement.

In general, the service provider must disclose in *writing* descriptions of or statements regarding:

1. The services to be provided;
2. If applicable, a statement that the service provider (and/or affiliate or subcontractor) will provide or reasonably expects to provide services as a fiduciary or as an investment advisor registered under the Investment Advisors Act of 1940 (or any state law);
3. All direct compensation that the service provider (and/or affiliate or subcontractor) expects to receive;
4. All indirect compensation that the service provider (and/or affiliate or subcontractor) expects to receive;
5. Any compensation that will be paid among related parties and its affiliates and/or subcontractors;
6. Any compensation that the service provider (and/or affiliate or subcontractor) reasonably expects to receive upon termination of the contract or arrangement; and
7. The manner in which the compensation will be received by the service provider (and/or affiliate or subcontractor).

There are additional, more detailed, disclosures for those service providers who provide recordkeeping services and also for service providers who act as fiduciaries to investment products or entities that hold plan assets in which the plan is invested.

Covered service providers include those who reasonably expect to receive at least $1,000 in direct or indirect compensation, and provide services generally described as follows:

Employers and service providers must begin work to meet the July, 2011 effective date

1. Fiduciaries under ERISA;
2. Fiduciaries to investment products or entities that hold plan assets in which the plan is invested;
3. Registered investment advisors;
4. Recordkeeping services to a plan allowing for participant directed investments;
5. Brokerage services to a plan allowing for participant directed investments; and
6. Other professional services (*e.g.*, legal, actuarial) if indirect compensation is expected.

Not surprisingly, given the DOL's keen interest in plan expense related issues, there is much more detail than we discuss here.

Plan Fiduciaries Must Act

Compliance with the regulations will impact and require effort by service providers and plan fiduciaries. The consequences of noncompliance will primarily consist of the imposition of excise taxes and penalties associated with prohibited transactions and the risk of liability for fiduciary breach (*i.e.*, personal liability for losses resulting from the breach). Notwithstanding, potential relief will be available to fiduciaries in narrow instances where the service provider refuses to make the necessary disclosures.

New ERISA Fee Disclosure Regulations - Continued

Plan fiduciaries are required to comply with these new ERISA rules. They must:

- Identify all providers of plan services;
- Determine those covered under the new rules;
- Contact them and request the required information; and
- Ensure the information meets the DOL's conditions.

Compliance will require effort, particularly initially when the rules take effect next year. Compliance is required on July 16, 2011, not after, and existing arrangements are fully subject to them. The work must begin and be completed before the effective date, and then on an ongoing basis as services or costs change.

Consider this: Participant directed investment accounts are popular for many plans, notwithstanding several distinct disadvantages to them. This new rule, however (to avoid it), is yet another reason for an employer to instead consider a trustee directed pooled account platform (this used to be the norm).

New Cafeteria Plan Rules Require Operational Changes and Amendments

Cafeteria plans, also known as flexible benefit or Section 125 plans, are impacted by recently enacted health care reform in several respects. These changes are staggered over a number of years. Two of the provisions in particular are effective January 1, 2011.

- First, new rules restrict reimbursements for certain over-the-counter medicines and drugs paid for on and after January 1, 2011.

- Second, employers may want to: (a) cover medical reimbursements on a pre-tax basis for children under the age of 27 (whether or not they are dependents); (b) allow payments on a pre-tax basis for the health premiums for such older children; and (c) allow election changes in connection with such older children becoming or not becoming covered under the employer's health plans.

Health care reform also means 125 plan changes

In addition to requiring operational compliance, the Internal Revenue Service is requiring plan amendments to reflect these new rules. Of course, summary plan descriptions must be modified accordingly as well. As a general rule, plan amendments for 125 plans must be executed before they become effective. The IRS is partially relaxing this deadline here.

For additional information regarding your circumstances, contact Jeff Mandell or John Hughes at (208) 342-5522 or 1-866-ERISALAW.

This alert is intended to provide general information only and does not provide legal advice. This bulletin does not discuss potential exceptions to the above rules. The application of ERISA laws can be complex. For information regarding the impact of these developments under your particular facts and circumstances, please call us. This material may also be considered attorney advertising under court rules of certain jurisdictions.

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