WSGR ALERT

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OBLIGATIONS AND LIABILITIES OF RETIREMENT PLAN FIDUCIARIES UNDER THE FINAL DOL FEE DISCLOSURE RULES

The U.S. Department of Labor (DOL) issued final regulations on February 3, 2012, regarding compensation, expense, and fee information that must be disclosed by retirement plan vendors (e.g., third-party administrators, brokers, consultants, advisors, and/or recordkeepers) to plan fiduciaries (e.g., the board of directors or members of an authorized committee of the board, officers, and other employees of the company responsible for plan administration).[1]

What Do the Regulations Mean to Retirement Plan Fiduciaries?

These regulations require vendors to disclose fee information, but it is the plan fiduciaries who will bear legal responsibility for (1) ensuring that vendors make proper disclosure, (2) reporting (and potentially terminating) vendors who fail to make proper disclosure, and (3) communicating information disclosed by vendors to plan participants (i.e., a vendor's violation of the fee disclosure rules potentially creates personal liability for plan fiduciaries).

I. Summary

Retirement plan vendors must meet their disclosure obligations by July 1, 2012. If a retirement plan vendor does not meet its disclosure obligations, the fees paid to the vendor could be deemed to be "prohibited transactions" under the Employee Retirement Income Security Act of 1974 (ERISA). To the extent a prohibited transaction is deemed to occur under ERISA, the DOL can assess significant civil penalties on plan fiduciaries, excise taxes apply under IRS rules, and the DOL may unwind the transaction.[2]

In addition, 401(k) plan fiduciaries will be required to disclose to participants the fees charged to the retirement plan and to participant accounts. 401(k) plan fiduciaries must provide a fee disclosure statement to participants no later than 60 days after the vendor fee disclosure deadline (i.e., no later than August 30, 2012).

As described in the **Plan Fiduciary Action Items** section below, the primary action item for retirement plan fiduciaries is to contact their plan vendors to ensure that appropriate steps are being taken to timely disclose fees.

II. Background

ERISA requires plan fiduciaries to enter into reasonable contracts and arrangements for the furnishing of goods, services, or facilities to a retirement plan that are necessary for the plan. Further, retirement plan vendors should only receive reasonable compensation for their services.

In recent years, a significant amount of litigation has transpired regarding retirement plan vendor fees. Plaintiffs claimed that the fees and expenses charged to plan participants were unreasonable and/or not appropriately reviewed by plan fiduciaries. Related claims often were made regarding allegations of mismanaged funds, conflicts of interest, and/or inadequate communication of fees and expenses to plan participants.

The DOL attempts to bring clarity to the fee landscape of retirement plan vendors by helping plan fiduciaries:

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[1] The final regulations are available at http://www.dol.gov/ebsa/pdf/2012-02262-PI1.pdf.

[2] To the extent a prohibited transaction occurs under ERISA, Section 502(i) of ERISA authorizes the DOL to assess a civil penalty of 5 percent of the amount involved as of the date the prohibited transaction occurred.

Another civil penalty may be assessed under Section 502(i) of ERISA equal to 100 percent of the amount involved if the prohibited transaction is not corrected (e.g., unwound) within 90 days after a final DOL prohibited transaction order is issued.

A mandatory civil penalty under Section 502(l) of ERISA can be assessed by the DOL 1) against a fiduciary who breaches a fiduciary duty or 2) against any other person who knowingly participates in such breach or violation. The penalty under Section 502(l) is equal to 20 percent of the applicable recovery amount that is paid pursuant to any settlement agreement with the DOL or that is ordered by a court to be paid in a judicial proceeding instituted by the DOL.

Vendors can be subject to the prohibited transaction excise tax rules under Section 4975 of the Internal Revenue Code (Code) if a prohibited transaction occurs due to a failure to disclose required fee information. Under Code Section 4975(a), the rate of the excise tax is 15 percent of the amount involved with respect to the prohibited transaction for each year (or part thereof) in the taxable period. The rate of the excise tax increases to 100 percent of the amount involved for each year (or part thereof) if the transaction is not corrected in the taxable period.

Continued on page 2...

Continued from page 1...

- assess whether a vendor contract, and the compensation and fees paid thereunder, is reasonable;
- identify potential conflicts of interest; and
- provide methods of communicating vendor compensation and fees to 401(k) plan participants.

III. Vendor Requirements

Who Must Comply?

A retirement plan vendor must comply with the final regulations if it is a "covered service provider" for a retirement plan that is subject to ERISA. A "covered service provider" is any vendor who (1) enters into a contract or arrangement with a retirement plan subject to ERISA and (2) reasonably expects to receive direct or indirect compensation of $1,000 or more for certain services.[3] "Compensation" is defined broadly to include money or anything else of monetary value.

Direct Compensation

Compensation is "direct compensation" if it is received by a vendor from a plan (e.g., from the trust, the plan forfeitures account, and/or an individual participant account). Direct compensation also includes compensation that is paid by the plan sponsor and later reimbursed from plan assets.

Indirect Compensation

Compensation is "indirect compensation" if it is received from a source other than the plan (or the plan sponsor) for services provided to the plan. Indirect compensation arrangements often arise when a vendor who receives direct compensation outsources certain aspects of the services arrangement to another organization or entity (e.g., accounting, auditing, legal, actuarial, appraisal, banking, consulting custodial, insurance, investment advisory (plan or participant), recordkeeping, securities or other investment brokerage, third-party administration, and/or valuation services). A few examples of indirect compensation are fees set on a transaction basis (e.g., commissions, soft dollars, finder fees) or fees charged directly against a plan's investments (e.g., 12b-1 fees, management fees, etc.).

A vendor must identify the services for which such compensation will be paid, as well as the payers and recipients of indirect compensation. The DOL included the requirement to disclose indirect compensation so that plan fiduciaries can identify potential conflicts of interest.

What Do Vendors Have to Disclose to Plan Fiduciaries?

Vendors must disclose (1) the services provided to the plan and (2) the fees from the plan, using communication techniques approved by the DOL. It is expected that these disclosures will be determined and appropriately identified in the administrative services agreement between the retirement plan and the vendor.

Summary of Services Provided

Vendors must describe all of the services provided to the plan, including services to be performed by affiliates and subcontractors. The level of detail required to appropriately describe the services will depend on the nature of the services; however, the summary must be clear and understandable. It also must explain whether the services provided by the vendor (and its affiliates and/or subcontractors) will be provided as a fiduciary to the plan and, if applicable, as a registered investment advisor, or both.

Summary of Compensation

Vendors must disclose:

- direct compensation (segregated by services provided or in the aggregate);
- indirect compensation for performing services under the contract, including descriptions of arrangements for indirect compensation;
- fees for recordkeeping services and, if recordkeeping services are bundled with other services, a separate description of the cost of the recordkeeping services;
- fees for brokerage services, if applicable;
- how transaction-based compensation is to be paid (e.g., commissions, soft dollars, finder fees);
- compensation charged directly against the plan's investment (e.g., 12b-1 fees, management fees, etc.);
- any compensation in connection with the termination of the contract or arrangement, and how any prepaid amounts will be calculated and refunded upon such termination; and
- the amount of fees charged to provide fiduciary services, if applicable.

A description of the fees may be expressed as a monetary amount, formula, percentage of the plan's assets, or a per capita charge for each participant or beneficiary. In addition, if the fees cannot reasonably be expressed using one of these description methods, then the final regulations allow for a description of the fees by any other reasonable method, including using a reasonable good-faith estimate if a vendor cannot readily describe compensation and the summary explains the methodology and assumptions used to prepare the estimate. The summary also should include a description of the method of receipt of compensation (e.g., direct billing, deduction from plan accounts, or charge against plan investments).

[3] Services may be direct, for example, by acting as a plan fiduciary, a fiduciary to a "plan asset" vehicle, a registered investment advisor, an investment advisor, a recordkeeper, and/or a brokerage service provider. Services also may be indirect and may include accounting, auditing, actuarial, appraisal, banking, consulting, custodial, insurance, investment advisory services for the plan or participants, legal, recordkeeping, securities or other investment brokerage, third-party administration, or valuation services provided to the covered plan, for which the covered service provider, an affiliate, or a subcontractor reasonably expects to receive indirect compensation or compensation paid among related parties.

Continued on page 3...

Continued from page 2...

Certain Investment Information

In addition, vendors must disclose certain investment information, such as annual operating expenses and information about qualified investment alternatives (e.g., the name and type of alternative, performance data, and/or benchmarks). However, recordkeepers and brokers potentially may rely on the investment-related disclosures by the issuers of investment alternatives (e.g., fund prospectuses), as long as the issuer meets certain requirements.

When Do Vendors Have to Disclose Fee Information to Plan Fiduciaries?

Initially, retirement plan vendors must meet their disclosure obligations by July 1, 2012. Thereafter, retirement plan vendors must notify the plan fiduciaries as soon as practicable (e.g., via an amended and/or restated services agreement) if compensation and/or fees change, but no later than 60 days from the date the vendor learns of the change. Further, vendors must notify plan fiduciaries at least annually regarding investment information changes (e.g., fund fees and expenses).

How Should Vendors Provide the Disclosures to Plan Fiduciaries?

The final regulations permit disclosures to be made in writing or electronically (provided that all appropriate information is accessible). The DOL included an appendix with the final regulations that sets out an example of how vendors should disclose the required information. The appendix is intended to be a guide that enables a plan fiduciary to easily locate vendor fee information that is otherwise disclosed through multiple documents or though complex arrangements. Currently, the use of the appendix is not legally required, but we expect the DOL to issue proposed regulations in the future that will require using the appendix approach in vendor service agreements.

IV. What Happens if a Vendor Makes a Mistake?

Inadvertent Disclosure Mistakes

The final regulations contemplate that vendors may make mistakes in disclosing required fee information. As a safe harbor, the DOL has provided that a disclosure mistake will not result in a prohibited transaction if the vendor can show that it (1) acted in good faith and with reasonable diligence and (2) disclosed the correct information as soon as practicable, but no later than 30 days after it knew of the error.

Limited Exemption from Liability for Plan Fiduciaries for Vendor Mistakes

If the safe harbor described above for an inadvertent disclosure mistake does not apply and a vendor did not comply with its fee disclosure obligations, a prohibited transaction class exemption is available for a plan fiduciary if certain conditions are met (which should mitigate the plan fiduciary's personal liability for the vendor's fee disclosure mistake). The plan fiduciary must show that it:

- did not know that the vendor failed (or would fail) to make the required disclosures and reasonably believed that the vendor complied with its disclosure obligations;
- made a written request that the vendor furnish the required information upon discovering the failure;
- notified the DOL if the service provider did not comply with the written request within 90 days; and
- made a determination as to whether to terminate or continue the service arrangement upon discovering the failure. If the information relates to future services and is not disclosed promptly after the 90-day period, the plan fiduciary must terminate the vendor's service arrangement as soon as possible.

The DOL has posted a model notice on its website that plan fiduciaries can use to notify the DOL if a retirement plan vendor fails to disclose fee information.[4]

V. Plan Fiduciary Requirements

What Must Plan Fiduciaries Communicate to Participants?

Pursuant to regulations under the exclusive purpose and prudence rules of ERISA Section 404 that were issued in 2010,[5] the DOL requires retirement plan fiduciaries of participant-directed individual account retirement plans, such as 401(k) plans, to make vendor compensation and fee-related disclosures to plan participants. The regulations require plan fiduciaries to provide plan participants with:

- annual disclosures regarding performance data, benchmark information, compensation, vendor compensation and fees, and investments available under the plan;
- disclosure when changes occur to vendor compensation and fees, as well as investments available under the plan;
- quarterly statements of the dollar amount of the plan-related compensation and fees actually charged to or deducted from a plan participant's individual account, along with a description of the services for which the charge or deduction was made; and
- access to supplemental investment information (e.g., SEC prospectuses, financial reports, and statements of valuation and of assets holdings).

[4] The model notice is available at http://www.dol.gov/ebsa/DelinquentServiceProviderDisclosureNotice.doc.

[5] The regulations may be accessed at http://www.dol.gov/ebsa/pdf/frparticipantfeerule.pdf.

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Obligations and Liabilities of Retirement Plan Fiduciaries . . .

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The DOL provides a model comparative chart in the 401(k) participant fee disclosure regulations that plan fiduciaries can use to communicate to plan participants. As described above, 401(k) participant fee disclosure is required 60 days after the vendor fee disclosure deadline (i.e., no later than August 30, 2012). To the extent that plan fiduciaries do not communicate these disclosures to plan participants, fiduciary liability may result due to a breach of the duty of care under Section 404 of ERISA.

How Will Disclosure Help Plan Fiduciaries?

The disclosure required under the final regulations is intended to help plan fiduciaries determine and understand the full compensation and fees charged by retirement plan vendors and their affiliates, which should assist in determining whether the arrangement is reasonable and appropriate for a retirement plan. In addition, the disclosure allows plan fiduciaries to effectively communicate the fee arrangements with plan participants.

We expect that the foregoing regulations will be used as both sword and shield in the future. In particular, where plan fiduciaries can point toward compliance with these rules, a potential defense may be established against litigation and/or the DOL. On the other hand, for vendors and plan fiduciaries who do not take the steps required in gathering and communicating required information, assessing compensation and fee information, and/or proactively determining whether service arrangements are reasonable, this new regulatory scheme expands liability under ERISA because claims regarding prohibited transactions and/or breaches of fiduciary duty may develop more easily.

VI. Plan Fiduciary Action Items

What Should Plan Fiduciaries Do Now?

Retirement plan fiduciaries should contact their plan vendors with the following action items in mind:

- Ensure that plan vendors are compiling data in relation to their disclosure obligations to the plan.
- Confirm that retirement plan vendors will meet their fee disclosure deadline.
- Determine if a new administrative services agreement is required and coordinate the execution of any agreement.
- Review and analyze each vendor fee disclosure for accuracy and reasonableness.
- Confirm that the plan's vendor has captured all indirect compensation relationships.
- Consult with legal counsel if plan fiduciaries are uncertain as to whether a vendor has satisfied its disclosure obligations.
- Also, with respect to 401(k) plans and other individual account plans:
  - Coordinate with retirement plan vendors and determine how participant disclosure requirements will be timely satisfied.
  - For plans where a vendor (e.g., the third-party administrator) drafts participant disclosures, consider contacting legal counsel to assist with reviewing the participant fee disclosures. Because plan fiduciaries remain legally responsible for the accuracy and timely delivery of participant disclosures, plan fiduciaries should review and monitor these types of participant disclosures.
  - For plans that will not have a vendor draft participant disclosures, review the model comparative chart developed by the DOL and consider contacting legal counsel to assist with participant fee disclosure compliance.

This WSGR Alert is intended only as a general summary of the disclosure regulations. For more information on plan disclosure and the specific requirements, please contact any member of the employee benefits and compensation practice at Wilson Sonsini Goodrich & Rosati.

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