

# Who's Paying Whom for What? The DOL Addresses Plan Fiduciary Obligations

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As if there weren't enough regulations for plan fiduciaries to deal with, on December 13, 2007, the U.S. Department of Labor (DOL) issued proposed regulations that require fiduciaries of employee benefit plans to obtain specific information on fees, compensation and conflicts of interest from certain service providers. The proposed regulations pertain to pension plans, group health plans and all other types of welfare plans. In conjunction with the proposed regulations, the DOL also proposed a class exemption that would (under specific circumstances) relieve plan fiduciaries from prohibited transaction liability if a fiduciary discovers that a service provider failed to disclose the required information.

The regulations rest on a counterintuitive provision of the Employee Retirement Income Security Act (ERISA) that prohibits a fiduciary from allowing the conveyance of money, goods or services between a plan and a party in interest unless the transaction qualifies for an exemption. Because the definition of "party in interest" includes all service providers, the result of this provision is that any provision of services to a plan is a prohibited transaction unless it qualifies for an exemption. Furthermore, both the fiduciary and the service provider are responsible for preventing prohibited transactions and both face consequences if the transaction is not exempt. Under the proposed regulations, a fiduciary must contractually obligate the service provider to disclose information about fees and potential conflicts in order for the transaction to qualify for an exemption.

## Proposed Disclosure Regulations

The proposals would require that a service provider be obligated to disclose information about that service provider's fees, compensation and existing or potential conflicts of interest to plan fiduciaries. Specifically, under the proposed regulations, a contract between a plan and a service provider is not "reasonable" (and not exempted from being a prohibited transaction under ERISA §408(b)(2)) unless the contract requires the service provider to disclose its direct and indirect compensation and potential conflicts of interest related to its services for the plan.

The broad range of service providers affected by the proposed regulations includes providers of banking, consulting, custodial, insurance, investment management or advisory, recordkeeping, brokerage and third-party administration services to plans. It also includes providers who receive indirect compensation in connection with legal, actuarial, accounting or auditing services. Indirect compensation encompasses fees that plan service providers receive from entities other than the plan, plan sponsor or service provider. The proposed regulations do not extend to contracts with entities that provide plan benefits to participants, rather than services to the plan.

## Compensation and Fees

The purpose of the proposed compensation and fee disclosure requirements is to provide plan fiduciaries with enough information to determine the soundness of the provider's fees and compensation. According to U.S. Secretary of Labor Elaine L. Chao, "We are working quickly to implement regulations that foster fair, competitive and transparent prices for services as well as combat excessive or hidden plan fees."<sup>1</sup> The DOL, therefore, proposes that every contract with certain plan service providers requires the provider to describe in writing all services it will provide to the plan and all direct and indirect compensation the provider (or any affiliate of the provider) will receive in connection with its services. If a provider cannot state a specific dollar amount for its services, then it could disclose its compensation and fees by using a formula, a percentage of plan assets or a per-participant charge.

The regulations limit this requirement to "contracts" between a plan and the following service providers:

- Fiduciaries of the plan
- Third-party administrators
- Entities that provide banking and/or custodial services
- Consultants
- Insurers
- Investment advisors
- Recordkeepers

Also, under the proposed regulation, a service provider contract must require the provider to disclose any information related to the contract and the provider's fees and compensation that are required by the fiduciary must comply with the reporting and disclosure obligations of Title I of ERISA.

Unclear in the regulations are arrangements between a plan and its third-party service providers which are not governed by contract. Many plan/provider relationships have never been put into writing, and instead, service providers are being paid by insurance carriers or vendors based upon broker or agent agreements.

It is a conservative assumption that the proposed regulations intend such arrangements to be subject to the plan fiduciary obligations. As soon as practical, it is advisable that fiduciaries gain an understanding of all compensation methodologies to ascertain the appropriateness of the arrangement.

### Conflicts of Interest

The proposed regulations also require service providers to disclose actual or potential conflicts of interest to plan fiduciaries. Under the proposals, a service provider would have to admit:

- its participation or interest in transactions to be entered into by the plan pursuant to the service contract.
- material relationships with other parties which have the potential for a conflict of interest.
- compensation it may receive that the provider can affect without prior approval by an independent fiduciary.
- the provider's policies and procedures to address potential conflicts of interest.

### Material Changes

Finally, if any of the information disclosed by the provider changes materially, the proposed regulations require the service provider to disclose those changes to fiduciaries within 30 days of the change.

### Proposed Class Exemption

The proposals emphasize that a service contract or arrangement that fails to require disclosure of the fees, compensation and conflict of interest information described in the proposed regulation will not be "reasonable." The contract or arrangement will, therefore, not qualify for exemption from ERISA's prohibited transaction rules and the plan's fiduciaries will have participated in a prohibited transaction. The provider will be subject to excise taxes (if applicable) under Internal Revenue Code §4975.



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<sup>1</sup> Quote from [www.erisarulesandregulations.com](http://www.erisarulesandregulations.com), "ERISA Rules and Regulations," accessed April 7, 2008.