

KELLY, HANNAFORD & BATTLES P.A.

ANTHONY R. BATTLES
JULE M. HANNAFORD IV
A. DAVID KELLY
THEODORE K. RICE
SONJA LEMMER MARTENS
HOLLY A. FISTLER

MARK D. MEYER
OF COUNSEL

ATTORNEYS AT LAW
900 BAKER BUILDING
706 SECOND AVENUE SOUTH
MINNEAPOLIS, MINNESOTA 55402
TELEPHONE (612) 341-0881
FACSIMILE (612) 341-1041
KHBLAW.COM

WRITER'S DIRECT DIAL:
612/455-6084
TRice@KHBlaw.com

WRITER'S DIRECT DIAL:
612/341-3398
HFistler@KHBlaw.com

August 12, 2010

Re: DOL Clarifies Requirements for Service Provider Fee Disclosures

Dear Clients and Other Friends:

Retirement plan service providers and plan sponsors now have definitive guidance on service provider fee disclosure requirements. Proposals for new fee disclosure requirements have been reviewed and debated for several years within the industry, at the Department of Labor and in Congressional hearings. Last month, the DOL published "interim final" regulations for service provider fee disclosures. Because these new rules are classified as "interim final" regulations, the DOL is entertaining comments on these new rules, which must be received by August 30, 2010.

These new fee disclosure rules were published in the Federal Register on July 16, 2010. See this link for a copy of the rules: <http://www.dol.gov/federalregister/PdfDisplay.aspx?DocId=24028>.

See the end of this client letter for list of action steps for plan sponsors and service providers and for your convenience a chart that summarizes requirements of the new fee disclosure rules.

Effective Date

These new fee disclosure rules are effective as of July 16, 2011, one year from the date of publication. Arrangements entered into prior to the effective date must satisfy the new disclosure rules as of the effective date. On and after July 16, 2011, a fee disclosure must be provided by a "covered service provider" to the plan sponsor before a plan service arrangement is entered into, extended or renewed. If fee arrangements change, a new disclosure is required to be made as soon as practicable but not more than 60 days following the change (any change; not just material changes). Also, within 30 days of a written request by a plan administrator, a service provider must provide a fee disclosure.

Background

There have been important changes to the way services are provided to retirement plans and in the way plan service providers are compensated. Although many of the changes to fee structures in the industry may have improved the efficiency and reduced costs of servicing retirement plans, the DOL notes that the complexity resulting from these changes has made it more difficult for plan sponsors and fiduciaries to understand what service providers are actually receiving for the specific services rendered.

The new fee disclosure rules are intended to clarify fee structures by providing guidance to plan fiduciaries and plan service providers about the requirements for complete and accurate disclosure of plan servicing arrangements. The interim final regulations are one of a set of three rules the DOL is establishing for fee disclosures. In addition, there are the new Form 5500 Schedule

C requirements for service provider fees effective for the 2009 Form 5500. Also, final participant fee disclosure regulations are expected to be issued as early as this fall.

These regulations are issued under ERISA § 408(b)(2) and also apply to interpretations under the prohibited transaction rules of Internal Revenue Code § 4975. ERISA § 408(b)(2) exempts reasonable plan service arrangements from being treated as prohibited transactions. The new regulations provide that a service arrangement is not “reasonable” (and therefore is a prohibited transaction) unless the fee disclosure requirements are satisfied. Plan fiduciaries and service providers that fail to meet the new disclosure obligations face harsh penalties.

Required Fee Disclosures

The new fee disclosure rules are intended to focus on service providers and compensation arrangements that are most likely to raise questions for plan fiduciaries with respect to the amount of compensation being received by a service provider and potential conflicts of interest that might compromise the quality of those services.

Under the new fee disclosure rules, plan sponsors and service providers must first determine which ERISA plans require fee disclosures. For these plans, a “Covered Service Provider” must provide a written fee disclosure to the plan fiduciary responsible for selecting plan service providers. Typically, this is the plan administrator/plan sponsor. Second, the new fee disclosure rules set forth criteria for determining who is a “Covered Service Provider” and therefore subject to the disclosure rules. Once the affected retirement plans and Covered Service Providers are identified, the third step is to determine which information must be disclosed to the plan sponsor. See the chart at the end of this client letter for a checklist summarizing these steps.

Information that must be disclosed includes a description of the services to be provided and all direct and indirect compensation to be received by the Covered Service Provider, its affiliates and subcontractors. Direct compensation is compensation received directly from the plan. Indirect compensation generally is compensation received from any source other than the plan, the plan sponsor, the Covered Service Provider or its affiliates or subcontractors.

The DOL asserts that because certain services and costs are so significant or present the potential for conflicts of interest, information concerning those services and costs must be disclosed without regard to whether services are furnished as part of a bundle or package. For example, Covered Service Providers must disclose whether they are providing recordkeeping services and the compensation attributable to such services, even when no explicit charge for recordkeeping is identified as part of the service contract. Also, Covered Service Providers must disclose whether they are providing any services as a fiduciary to the plan.

Information must also be disclosed about plan investments and investment options. These disclosure obligations are placed on the fiduciaries of investment vehicles that hold plan assets and on recordkeepers and brokers who, through a platform or similar arrangement, facilitate the investment in various options by participants in individual account plans, such as 401(k) plans.

Finally, the DOL provides that the new fee disclosure regulations do not pre-empt applicable state law requirements of contract, tax, consumer protection and other laws except to the extent that the state law prevents the application of the new DOL fee disclosure regulation.

Good Faith Disclosure Errors may be Corrected by Service Providers

The new rules provide that no prohibited transaction will result due to a good faith error or omission by a Covered Service Provider with respect to a particular fee disclosure but only if the service provider discloses the correct information as soon as practicable and no more later than 30 days after it learns of such error or omission. This rule establishes a means for Covered Service Providers to self-correct good faith disclosure errors.

New Exemption from Prohibited Transactions for Certain Disclosure Failures

The interim final regulation includes a class exemption from ERISA's prohibited transaction rules for a plan fiduciary that enters into a plan service arrangement without knowing that the Covered Service Provider has failed to comply with its disclosure obligations. Otherwise, such a failure could constitute a prohibited transaction relating to the service arrangement. Upon discovery that a required fee disclosure has not been received, the plan fiduciary must send a written request to the service provider asking to receive the required fee disclosure.

If the Covered Service Provider fails to provide the required fee disclosure within 90 days of such a request, the responsible plan fiduciary must notify the DOL of the service provider's failure. This notice to the DOL must include the following information:

1. The name of the covered plan;
2. The plan number used for Form 5500 filings;
3. The plan sponsor's name, address and EIN;
4. The name, address and telephone number of the responsible plan fiduciary;
5. The name, address, telephone number and, if known, EIN of the Covered Service Provider;
6. A description of the services provided to the covered plan;
7. A description of the information that the Covered Service Provider failed to disclose;
8. The date such information was requested in writing from the Covered Service Provider; and
9. A statement whether the Covered Service Provider continues to provide services to the plan.

The plan fiduciary is required to file this notice to the DOL within 30 days following the earlier of: (1) the provider's refusal to provide a requested fee disclosure, or (2) the provider's failure to respond within 90 days of the plan fiduciary's written request to receive a fee disclosure. The plan fiduciary in this circumstance must determine whether to continue or terminate the plan's relationship with the service provider. Because the new rules are not effective until July 16, 2011, Covered Service Providers and plan fiduciaries have until that time to assure that complying fee disclosures are made for existing service arrangements.

No Model Fee Disclosure Form Provided by the DOL

In issuing these new fee disclosure rules, the DOL did not issue a model/template form to assist covered service providers with making disclosures required under the new rules. In the regulation's preamble, the DOL expressed concern about whether a model form could be drafted that would adequately apply to the variety of service and fee arrangements available to plans. The DOL further noted that in lieu of issuing a model form, it may add a requirement that covered service providers furnish a "summary" disclosure statement of one or two pages. The DOL encourages interested persons to submit comments on these matters. These comments may convince the DOL to issue one or more model fee disclosure forms.

Conclusion

Addressing the details of these new disclosure requirements will be a substantial undertaking by plan service providers and plan sponsors. We hope that this client letter, the action steps below and the chart at the end of this client letter will help with you understand these important new fee disclosure rules. Please contact us if we may be of assistance to you in addressing these new fee disclosure requirements.

Action steps!

<u>Plan Sponsors</u>	<u>Service Providers</u>
1. Learn the new fee disclosure requirements.	1. Learn the new fee disclosure requirements.
2. Identify “Covered Service Providers” that need to provide complying fee disclosures.	2. Review/confirm status as a “Covered Service Provider” under the provider’s plan service arrangements.
3. Set timetable/project plan to assure receipt of complying disclosure from service providers by July 16, 2011 for existing service arrangements.	3. Set timetable/project plan to provide plan sponsors complying fee disclosures before July 16, 2011 for existing service arrangements.
4. Require receipt of complying fee disclosures in advance of any new plan service arrangements.	4. Set a timetable to provide plan sponsors with complying fee disclosures prior to the establishment of new plan service arrangements (for new arrangements beginning July 16, 2011 or later; though earlier fee disclosure compliance is advisable).
5. Review fee disclosures received to confirm compliance with new disclosure requirements.	5. Prepare/review fee disclosures to assure compliance with the new disclosure rules; including applicable recordkeeping and investment fund disclosures.
6. Retain received fee disclosures to document ongoing compliance and for future reference.	6. Promptly respond (within 30 days in any event) to written plan sponsor requests for fee disclosures – and assure that disclosures comply with the new fee disclosure rules.
7. As necessary, address the DOL reporting requirement for any failures by service providers to provide requested fee disclosures.	7. Promptly prepare and provide plan sponsors revised fee disclosures (within 60 days in any event) following any change to fees.
8. Consider the need for training and/or external compliance review of fee disclosures received.	8. Consider the need to conduct staff training of the new fee disclosure requirements, stressing the importance of providing complying initial fee disclosures and promptly responding to fee changes and plan sponsor requests.
	9. Retain records evidencing compliance with fee disclosure requirements.

Please contact us with questions about these important new rules and for assistance with required fee disclosures.

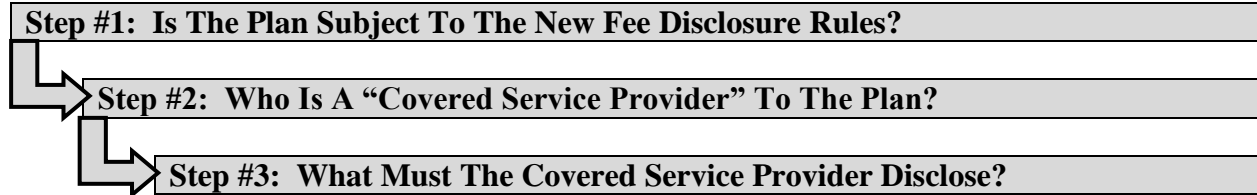
Sincerely,

Theodore K. Rice

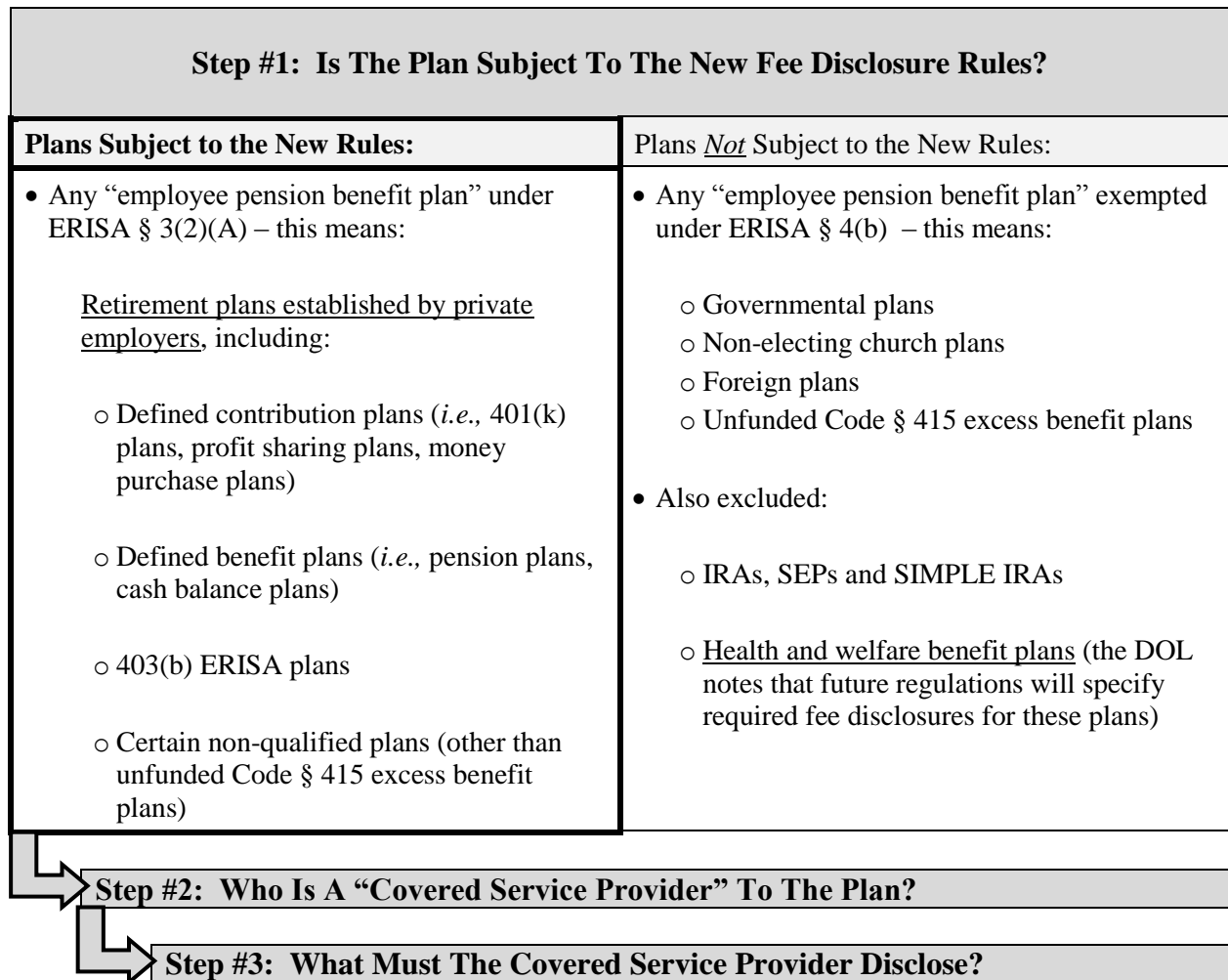
Holly A. Fistler

A Step-by-Step Approach to the New Service Provider Fee Disclosures

These new fee disclosure rules may be broken down into three main areas of analysis for service providers and plan fiduciaries:



* * *
* * *



Step #1: The Plan Is Subject To The New Fee Disclosure Rules.

Step #2: Who Is A “Covered Service Provider” To The Plan?

“Covered Service Provider”:	Not Covered:		
<ul style="list-style-type: none"> • <u>ERISA fiduciaries</u>, such as trustees or investment managers, including: <ul style="list-style-type: none"> ○ <u>Registered investment advisors</u> (under Investment Advisers Act of 1940 or any state law). ○ <u>Fiduciaries to “plan asset” investment vehicles in which the plan has a “direct equity investment”</u> – these service providers are ERISA fiduciaries by virtue of providing fiduciary services to a “plan asset” investment vehicle in which a plan invests (a “<i>direct equity investment vehicle</i>”). A “plan asset” investment vehicle is one determined as such under DOL plan asset regulations (DOL Reg. § 2510.3-101). Such vehicles include: <ul style="list-style-type: none"> ▪ A bank-sponsored collective investment fund, ▪ An insurance company separate account, or ▪ Certain private investment funds treated as holding plan assets under DOL plan asset regulations. The new rules provide that investments made by any <i>direct equity investment vehicle</i> held by a plan are not considered. Also, mutual funds are <u>not</u> <i>direct equity investment vehicles</i>. ○ <u>Recordkeepers or brokers</u> to participant-directed defined contribution plans if they make investment alternatives available through a platform or similar arrangement ○ <u>Other service providers</u> who reasonably expect to receive <u>indirect compensation</u>, including: <table border="0" style="width: 100%;"> <tr> <td style="vertical-align: top;"> <ul style="list-style-type: none"> ▪ Accounting ▪ Auditing ▪ Actuarial ▪ Appraisal/Valuation ▪ Banking ▪ Consulting (generally investment-related or selection of service providers) </td> <td style="vertical-align: top;"> <ul style="list-style-type: none"> ▪ Custodial ▪ Insurance ▪ Investment advisory (for plan participants) ▪ Legal ▪ Recordkeeping ▪ Securities/investment brokerage ▪ Third party administration </td> </tr> </table> 	<ul style="list-style-type: none"> ▪ Accounting ▪ Auditing ▪ Actuarial ▪ Appraisal/Valuation ▪ Banking ▪ Consulting (generally investment-related or selection of service providers) 	<ul style="list-style-type: none"> ▪ Custodial ▪ Insurance ▪ Investment advisory (for plan participants) ▪ Legal ▪ Recordkeeping ▪ Securities/investment brokerage ▪ Third party administration 	<ul style="list-style-type: none"> • <u>Service providers</u> who reasonably expect to receive <u>less than \$1,000</u> of “direct” or “indirect” compensation* for plan services • <u>Affiliates and subcontractors of Covered Service Providers</u> (generally, a Covered Service Provider is responsible for these related party fee disclosures) • <u>Other service providers</u> (see the last category in the column to the left) who reasonably expect only to receive <u>direct compensation</u> in connection with services <p>* “Direct” compensation is compensation received directly from the plan (does not include compensation paid by the plan sponsor). “Indirect” compensation generally is compensation received from any source other than the plan, the plan sponsor, the Covered Service Provider or its affiliates or subcontractors.</p>
<ul style="list-style-type: none"> ▪ Accounting ▪ Auditing ▪ Actuarial ▪ Appraisal/Valuation ▪ Banking ▪ Consulting (generally investment-related or selection of service providers) 	<ul style="list-style-type: none"> ▪ Custodial ▪ Insurance ▪ Investment advisory (for plan participants) ▪ Legal ▪ Recordkeeping ▪ Securities/investment brokerage ▪ Third party administration 		

Step #3: What Must The Covered Service Provider Disclose?

Step #1: The Plan Is Subject To The New Fee Disclosure Rules.

Step #2: The Service Provider Is A “Covered Service Provider” To The Plan.

Step #3: What Must The Covered Service Provider Disclose?

<u>Services:</u>	A description of the plan services to be provided.
<u>Status as Fiduciary or RIA:</u>	As applicable, a statement that the Covered Service Provider will provide services to the Plan as a <u>fiduciary or registered investment advisor</u> (registered under the Investment Advisers Act of 1940 or any state law)
<u>Compensation of Covered Service Provider, an Affiliate or a Subcontractor:</u>	<ul style="list-style-type: none"> • <u>Direct compensation</u> paid by the plan. • <u>Indirect compensation</u> and services giving rise to such compensation. • <u>Compensation paid among related parties</u> of the Covered Service Provider.if (a) set on a transaction basis (e.g., incentive compensation such as commissions, soft dollars or finder’s fees), or (b) is charged directly against the plan’s investments and reflected in the net value of the investment (e.g., 12b-1 fees). • <u>Termination charges.</u>
<u>Recordkeeping Services – for 401(k) Plans and other Individual Account Plans:</u>	All direct and indirect compensation, including: <ul style="list-style-type: none"> • a description of any fee offset arrangements or revenue sharing that pay for recordkeeping services; and • a description of the reasonable costs of such recordkeeping services.
<u>Manner of Receipt:</u>	<ul style="list-style-type: none"> • A description of how compensation will be received, such as whether the plan will be (a) billed for fees, (b) fees will be directly deducted from the plan’s accounts or (c) fees will be directly deducted from investments held by the plan.
<u>Investment Disclosure -- Fiduciary Services to Direct Equity Investment Vehicles:</u>	Unless otherwise disclosed by a recordkeeper or broker, a Covered Service Provider that is a <u>fiduciary</u> to a <i>direct equity investment vehicle</i> (see Step 2 on this chart) must disclose: <ul style="list-style-type: none"> • compensation assessed directly against the amount invested – such as sales loads, deferred sales charges, redemption fees, account fees, etc., • annual expense ratio of the <i>direct equity investment vehicle</i>, and • ongoing operating expenses – such as wrap fees, mortality and expense fees.
<u>Investment Disclosure – Investment Funds on Participant-Directed Investment Platforms:</u>	Unless otherwise provided by an investment fiduciary, a recordkeeper or brokerage that offers a platform of investment options to participant-directed individual account plans must disclose information regarding each designated investment option available through the platform. <ul style="list-style-type: none"> • The investment fund compensation and operating expenses to be disclosed are the same categories as noted in the box above this box. • The rules allow current disclosure materials of the issuer (a mutual fund prospectus for example) to be provided in satisfaction of this disclosure requirement (except for situations where the issuer is affiliated with the recordkeeper or brokerage).

Kelly, Hannaford & Battles, P.A.

www.KHBlaw.com – 612.341.0881 – August 2010

Service Provider Fee Disclosure Chart – Page 3