Regulation on service provider fee disclosures for ERISA retirement plans

MetLife

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About MetLife Resources

MetLife Resources is a Division of Metropolitan Life Insurance Company ("MetLife"), New York, NY 10166, that specializes in providing retirement program products and services to education, non-profit, governmental and healthcare employers and their employees. MetLife Resources offers defined contribution retirement plan services to more than 10,000 employer groups and services retirement plans with more than $15 billion in nonprofit retirement plan assets.[1]

Why MetLife prepared this paper

MetLife focuses on understanding and serving our customers through changing times. We build on this tradition by delivering leading insights through nationally acclaimed research, subject matter experts and educational resources. We serve as a leading voice on employee benefits by actively influencing public policy, educating the media and developing intelligent product solutions.

When you're aligned with a company known as an industry thought leader, you can count on the support you need to make informed decisions. We hope you will find this information useful as you prepare to meet the requirements of the regulation.

1. As of 3/31/2021.

Introduction

As an ERISA plan fiduciary, you have important responsibilities related to your plan and must act in the best interests of your participants and their beneficiaries. These responsibilities include:

- Carrying out your duties prudently
- Following the terms of your plan documents
- Diversifying plan investment choices
- Paying reasonable compensation for plan services

For most of these responsibilities, the Department of Labor (DOL) and the courts have provided guidance and interpretations which have helped plan sponsors meet their fiduciary duties. The DOL has expressed concern in recent years that increasing complexity in the way plan service providers are compensated may have made it difficult for plan sponsors and fiduciaries to understand the actual costs to the plan of services rendered. The DOL believed further regulation was needed to assure the availability of fee information to plan fiduciaries. In 2012, the DOL issued the service provider fee disclosure regulation (alternatively referred to as the "408(b)(2) regulation").

The 408(b)(2) regulation requires certain categories of service providers to ERISA employee pension benefit plans to make disclosures about the direct and indirect compensation they receive for their services. The regulation sets fee disclosure standards for plan service providers, resulting in a more clear and consistent communication of fees across the service provider community.

The purpose of this paper is to help you understand the DOL 408(b)(2) regulation and how it affects your role as a plan fiduciary.

Fee disclosure standards for plan service providers will result in more clear and consistent communications.

408(b)(2) fee disclosure regulation

ERISA contains an exemption from its prohibited transaction provisions for reasonable service arrangements. The exemption is available for arrangements that are necessary for the establishment or operation of the plan and for which no more than reasonable compensation is paid. This is generally referred to as the "reasonable services" exemption under ERISA Section 408(b)(2).

The purpose of the 408(b)(2) regulation is to assure the availability of service provider compensation information to the plan fiduciaries who are responsible for making determinations about the reasonableness of service provider costs. The Department also thought that plan fiduciaries need to be in a better position to assess any potential conflicts of interest between service providers and third parties where service providers receive compensation through plan investments.

The consequences of a failure to comply are significant. Where the disclosures required by the regulation are not provided, the contract or arrangement will not be considered to be reasonable, and therefore will not meet the conditions of the exemption for reasonable services under ERISA Section 408(b)(2). If a service arrangement is a "non-exempt" arrangement, the service provider could be liable for correction and prohibited transaction excise taxes and the plan fiduciary responsible for selecting the service provider could be liable, as an ERISA fiduciary, for the prohibited transaction. To avoid the possibility of such a result, it is in the interests of plan fiduciaries and service providers alike to see that disclosures have been made in satisfaction of the regulation.

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Covered service providers and covered plans

The disclosure requirements under the 408(b)(2) regulation apply to "covered service providers" to "covered plans."

Covered plans include ERISA pension and defined contribution plans, such as a 401(k) and ERISA 403(b) plans. Under the regulation, 403(b) plans that consist exclusively of frozen custodial or annuity contracts where the sponsor ceased making contributions for periods before January 1, 2009 are not included as covered plans. Also not included are SEPs, SIMPLE Retirement Accounts, IRAs, Keogh, Health Saving Accounts or accounts for which the DOL has provided relief from ERISA's Form 5500 requirements. Welfare benefit plans are also excluded from the definition of a covered plan, at least for the time being, pending further DOL rulemaking.

Under the regulation, a "covered service provider" is a service provider that enters into a contract or arrangement with the covered plan and reasonably expects that it will receive (together with affiliates or subcontractors) $1,000 or more in compensation over the term of the arrangement for providing one or more services specified by the regulation.

Specified services include:

- **Fiduciary Services** — Services provided directly to the covered plan as an ERISA fiduciary and anyone who provides services as a fiduciary to investment contracts or products that hold "plan assets" for investment by a covered plan.
- **Investment Advisers** — Services provided to a covered plan as an Investment adviser (under either the Investment Advisers Act of 1940 or under state law).
- **Recordkeeping or Brokerage Services** — Services provided to a covered plan that is a participant-directed individual account plan, such as a 401(k) or ERISA-covered 403(b) plan, if one or more of the plan's designated investment alternatives are available in connection with the recordkeeping or brokerage services through a platform or similar mechanism.
- **Other Services for Indirect Compensation** — Accounting, auditing, actuarial, appraisal, banking, consulting, custodial, insurance, investment advisory, legal, recordkeeping, securities or other investment brokerage, third party administration or valuation services for which the covered service provider, an affiliate or subcontractor expects to receive "indirect compensation" (i.e., compensation received from sources other than the plan, plan sponsor, covered service provider, affiliates, or subcontractors).

Frozen custodial or annuity contracts where the sponsor ceased making contributions for periods before January 1, 2009, are not included as covered plans.

DOL disclosure requirements

Plan fiduciaries must have sufficient information to make informed decisions about services provided to the plans they serve. To that end, covered service providers must disclose specified information contained within the 408(b)(2) regulation to a "responsible plan fiduciary," which is a fiduciary with authority to cause the covered plan to enter into, or extend or renew, the contract or arrangement.

The regulation defines what must be disclosed. Although the disclosures do not need to be made in a particular style or format, the DOL has provided a sample guide in the appendix of the final regulation as a suggestion for how the disclosure might be framed. The guide may also be used as a basic framework to assist plan fiduciaries in reviewing the disclosures they receive. This guide can be found by viewing the final 408(b)(2) regulation at **dol.gov/ebsa/**.

Disclosures provided under the regulation must be in writing, but they do not need to be part of any written contract for services.

The disclosure must include the following:

- **Description of Services:** An explanation of the types of services provided to the covered plan under the contract or arrangement.
- **Statement of Fiduciary or Investment Adviser Status:** If applicable, a statement that the covered service provider, an affiliate or subcontractor will provide, or reasonably expects to provide, services as an ERISA fiduciary to the plan (or to an investment contract or product owned by the plan that holds plan assets), or services directly to the plan as an investment adviser registered under either the Investment Advisers Act of 1940 or any state law.
- **Direct Compensation:** A description of all compensation received directly from the plan, either in aggregate or by service, that the covered service provider, an affiliate or subcontractor reasonably expects to receive in connection with covered services, including compensation that is initially paid by the plan sponsor but is then reimbursed from the plan.
- **Indirect Compensation:** A description of compensation from sources other than the plan, plan sponsor, covered service provider, its affiliates or subcontractors that the covered service provider, an affiliate or subcontractor reasonably expects to receive in connection with the services described in the regulations. For example, 12b-1 fees or revenue sharing payments received by the service provider from mutual funds would be considered indirect compensation. In addition, the final 408(b)(2) regulation requires the identification of the payer of the indirect compensation, the services for which the indirect compensation is received, and a description of the arrangement under which the indirect compensation will be paid. The DOL intends that this description of indirect compensation will assist plan fiduciaries in understanding whether a service provider may have a potential conflict of interest.
- **Manner of Receipt:** A description of how the compensation will be received, such as whether the plan will be billed or if the compensation will be deducted from the plan's accounts or investments.
- **Compensation Among Related Parties:** A description of compensation that is paid among and between a covered service provider and an affiliate or subcontractor if it is:
  (1) Set on a transaction basis. Examples include commissions, finder's fees or other similar incentive compensation based on business placed or retained, or
  (2) Charged directly against the plan's investments and reflected in the net value of the investments. An example is 12b-1 fees.
- **Termination Compensation:** A description of any compensation that the covered service provider, an affiliate, or a subcontractor reasonably would expect to receive in connection with the termination of the contract or arrangement and how any prepaid amounts will be calculated and refunded upon such termination.

Besides the previously mentioned disclosures, certain additional disclosure obligations apply to some service providers in connection with recordkeeping and brokerage services provided to participant-directed plans and in connection with investment products, including the following:

- **Good Faith Estimate of Recordkeeping Costs** — Covered service providers must describe the recordkeeping services that are provided. In addition, if there is no explicit charge for recordkeeping services (for example, recordkeeping fees are "bundled" with other service fees) or when compensation for recordkeeping services is offset or rebated based on other compensation received, the covered service provider must include a "reasonable and good faith estimate" of recordkeeping costs to the covered plan. The good faith estimate must include an explanation of the methodology and assumptions used to prepare the estimate, and a detailed explanation of the recordkeeping services that will be provided to the plan, taking into account the rates that the covered service provider, an affiliate or a subcontractor would charge to third parties or the prevailing market rates charged for similar services for a like plan.
- **Investment Disclosures — Participant-Directed Plans** — Covered service providers of recordkeeping and brokerage services and fiduciaries to investment contracts or products with plan assets are also required to provide additional investment-related disclosures when they provide services in connection with designated investment alternatives under a participant-directed plan, including information about investment fees and expenses, performance and other information. This requirement is intended to ensure that plan fiduciaries receive information about the plan's designated investment alternatives that will be needed under the DOL's regulations that require plan administrators to deliver the investment disclosures to plan participants. The regulation provides that fiduciaries of investment products and contracts are not required to deliver these investment-related disclosures if that information has already been provided by the plan's recordkeeper or broker.
- **Investment Disclosures — Other Plans** — For plans that are not participant-directed, fiduciaries to investment products and contracts with plan assets are required to provide information about investment expenses including:
    (1) A description of compensation that will be charged directly against an investment (e.g., sales loads, sales charges, redemption fees and surrender charges), and
    (2) A description of the annual operating expenses (e.g., expense ratio) if the return is not fixed.

Timing of required disclosures

The DOL not only defined what information must be disclosed to plan sponsors, but it also provided requirements as to how often the disclosures must be delivered.

Initial Disclosure — A covered service provider must provide the required disclosures to the responsible plan fiduciary reasonably in advance of the date the contract is entered into, extended or renewed.

For a new designated investment alternative, the required information must be disclosed as soon as practicable, but not later than the date the investment is added to the plan.

Modifications — A covered service provider must disclose a change to the information required in the initial disclosure as soon as practicable, but no later than 60 days from the date the covered service provider is informed of the change unless the disclosure is precluded due to extraordinary circumstances beyond the control of the service provider. In this case, the information must be disclosed as soon as practicable. Investment disclosures may be updated annually.

Upon Request Information — If the responsible plan fiduciary requests in writing any other compensation information that is required for the plan to comply with the ERISA reporting and disclosure requirements, the covered service provider must provide it reasonably in advance of the date on which the requesting fiduciary states that it must comply with the applicable reporting or disclosure requirement, subject to an exception in the event of extraordinary circumstances beyond the covered service provider's control. If there are extraordinary circumstances beyond the control of the covered service provider that preclude this disclosure, then the information must be furnished as soon as practicable.

Fiduciary relief

The 408(b)(2) regulation includes a class exemption for plan fiduciaries that will protect them from certain prohibited transaction liability if their covered service provider fails to provide the required disclosures. The plan may qualify for the class exemption if the plan fiduciary did not know that the covered service provider did not, or would not, supply the required disclosures and if a plan fiduciary reasonably believed the covered service provider disclosed the required information. In these occurrences, the plan fiduciary must do the following:

(1) Submit a written request to the service provider for the required information.

(2) Notify the DOL if the service provider does not comply with the request within 90 days.

The notice should be filed with the DOL no later than 30 days following the earlier of the covered service provider's refusal to provide the requested information or the date which is 90 days after the date the written request is made.

If a covered service provider fails to timely comply with the plan's written request for information relating to future services, the regulation requires the plan fiduciary to terminate the service arrangement as expeditiously as possible, consistent with the duty of prudence.

The DOL has developed a sample Delinquent Service Provider Disclosure Notice that is available on their website at **dol.gov.** The notice may be sent electronically to **OE-DelinquentSPnotice@dol.gov.**

Plan fiduciaries will be protected from certain prohibited transaction liability.

Errors and Omissions — There is relief for inadvertent disclosure errors. The plan will remain in compliance with the 408(b)(2) regulation if a covered service provider, acting in good faith and with reasonable diligence, makes an error or omission in disclosing required information provided that the covered service provider discloses the correct information to the plan fiduciary as soon as practicable, but not later than 30 days from the date on which the covered service provider knows of an error or omission.

Analyzing plan fees

Plan fiduciaries are obligated under the ERISA duty of prudence to carefully consider and evaluate the disclosures they receive from service providers under the 408(b)(2) regulation. The cost and quality of services should be evaluated, with appropriate consideration to potential conflicts of interest that might affect the quality of the provided services. When performing that evaluation, please keep in mind that the lowest cost provider may not necessarily be the best fit for a plan's needs. The quality of services also needs to be taken into account along with cost considerations. Examples of qualitative factors include:

- Financial stability of provider
- Provider reputation
- Range of products and services
- Education and financial guidance at the workplace
- Investment advisory services
- Flexible plan design
- Plan sponsor and participant satisfaction
- Quality of client service
- Commitment to innovative technology

The lowest-cost provider may not be the best fit for a plan's needs.

The information provided by the service provider should facilitate a more complete analysis of plan costs. The 408(b)(2) regulation underscores that plan management activity is an important component in complying with overall ERISA responsibilities.

Summary

In selecting or monitoring service providers and plan investments, ERISA requires plan fiduciaries to act prudently and solely in the interest of plan participants and beneficiaries. Plan fiduciaries must also act for the exclusive purpose of providing benefits with reasonable administrative costs. The disclosure requirements of the final 408(b)(2) regulation are intended to enable plan fiduciaries to fulfill these responsibilities.

MetLife understands the need for fee disclosure and supports the intent of the regulation. Service providers across the industry must now provide sufficient detail so that plan fiduciaries can analyze fees. And, in turn, pursuant to the regulations under the participant-directed individual account plans, plan sponsors must disclose and explain related fee and investment information to their plan participants.

The 408(b)(2) regulation should result in plan sponsors who are more informed and better equipped to act in the best interest of their participants. In addition, as plan costs are identified with payment detail, plan sponsors will be in a better position to make plan expense decisions that can benefit their participants.

The following checklist may be helpful as you evaluate your plan service provider fees on an ongoing basis:

Sample fee oversight checklist

☑ **Make sure you receive required disclosure(s) from all covered service providers under your plan on a timely basis.**

☑ **Establish a policy for ongoing fee review as part of your fiduciary process.**

☑ **When considering plan fund selection, in addition to fund fees, also consider other factors such as investment fund performance, characteristics, quality, risk, manager tenure and volatility.**

☑ **Include investment cost analysis as one of your criteria in your annual plan and/or investment review.**

☑ **Document your oversight activities.**

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Notes

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Any discussion of taxes is for general informational purposes only, does not purport to be complete or cover every situation, and should not be construed as legal, tax or accounting advice. Clients should confer with their qualified legal, tax and accounting advisors as appropriate.

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