

A Blue Cross and Blue Shield Association Presentation

Emerging Standards: ERISA Service Contracting & Fee Disclosure

Panel Presentation: Reporting & Disclosure of Fees for
401(k) and Other Plans – Coping With the New Regime

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Overview

Fiduciaries managing ERISA programs
(& fiduciary & non-fiduciary service
providers supporting their efforts) must
revisit their service arrangements to
assure they will satisfy new formality &
transparency standards

Drivers Contributing to New Standards

Overview

- 401(k) fee cases
- Series of DOL fee transparency initiatives
- More challenging audits including rising expectations regarding “control” processes
- GAO Report critical of DOL zeal on 401(k) fees
- SEC pressure for more mutual fund disclosures
- Congressional 401(k) fee transparency proposals

Our Focus

Overview

- DOL’s multi-faceted fee transparency Initiatives & the ERISA rules on which they are based
- Likely practical impact of these proposals on:
 - Vendors of plan services
 - Administration services (e.g., insurers, TPAs, record keepers, consultants, actuaries, accountants, attorneys)
 - Investment services (e.g., mutual funds, investment managers, custodians, investment advisers, bundled record keepers)
 - Placement services (e.g., insurance & other brokers)
 - Fiduciaries (e.g., plan administrators, investment committees)

DOL Initiatives

- Direct DOL initiatives:
 - Revised “reasonable contract” regulation
 - Expanded 5500 reporting & instant public access
 - Expanded participant disclosures
- DOL initiatives designed to support the efforts of other entities or spur others into action
 - Amicus Curiae briefs in support of 401(k) cases
 - Audits of auditors
 - Support for new GAO & SEC initiatives
 - Selective support for Legislation

Reasonable Contract Regulations

DOL: 408(b)(2)

DOL using ERISA interpretive authority to reinterpret a prohibited transaction exemption to significantly change service contracting practices

- Current rules
 - Underlying ERISA prohibitions
 - Existing service contracting practices that qualify for exemptions from those ERISA’s prohibitions
- Impact of new ERISA §408(b)(2) interpretation on
 - service contracting standards
 - disclosures between service providers & the ERISA fiduciaries that hire them

Background: ERISA Prohibited Transactions

DOL: 408(b)(2)

- Service provider or other party in interest must not engage in prohibited transactions with program
- Examples include direct or indirect:
 - Furnishing (or receiving) goods, services or facilities
 - Sales, exchanges or leasing (to or from)
 - Lending or other extension of credit (to or from)
 - Certain other self dealing or conflict transactions

Background: Prohibited Transactions Enforcement

DOL: 408(b)(2)

- Service provider or other party in interest
 - Activity must cease & transaction must be rescinded
 - Confiscatory penalty = 15% amount involved per year, stepping up to 100% of amount involved for failure to correct after notice:
 - Qualified retirement plan = IRS collects as excise tax
 - Other ERISA plans = DOL collects as civil penalty
 - DOL have primary enforcement & interpretive authority
- ERISA fiduciary duty to prevent prohibited transactions
 - Federal courts may hold fiduciaries personally liable for harm due to failure to prevent prohibited transactions
 - If prohibited transaction not corrected, DOL may impose a penalty on the fiduciary = 20% of amount the plan recovers

Background: Prohibited Transaction Exemptions

DOL: 408(b)(2)

- Statutory Exemptions:
 - ERISA §408(b)(2) Exemption [*subject of new DOL proposal*]
 - Compensated or uncompensated “necessary” services or office space may be provided to program pursuant to a “reasonable” arrangement
 - Other Exemptions (ERISA §408(c)) [*unchanged*]
 - Reimbursement (no profit element) for program costs OK
 - Benefit payments (Contributions need no exemption)
 - Occupying dual role as officer or employee & fiduciary
- DOL has the authority to issue administrative exemptions
 - Many have been granted
 - Individual exemptions: cover specific parties/transactions
 - Class exemptions: cover described class of transactions

Current Regulations, Cases, and Rulings: Necessary Services Exemption Requirements

DOL: 408(b)(2)

- Services/office space necessary for ERISA program establishment or operation
 - Traditional “appropriate and helpful” test
 - Provision of goods “incidental” to services performance OK
- Reasonable contract or arrangement
 - No requirement that the contract or arrangement be in writing
 - Written agreements are best evidence of reasonableness & enforceability
 - Terms must be reasonable:
 - Aside from compensation, current regulations only offer a single example:
 - Generally, must be cancellable by program on short notice without penalty
- Compensation
 - Exemption applies to uncompensated as well as paid services or office space
 - Compensation must be reasonable
 - Facts & circumstances test
 - Advance payment of estimated reimbursable expenses OK if reasonable estimate of near term expenses & properly accounted for after the fact
 - Compensation to fiduciary not exempt unless approved by an independent fiduciary

Proposed Regulation: Necessary Services Exemption Requirements

DOL: 408(b)(2)

- Scope of regulation unchanged
 - Same tests of necessity of services/office space & incidental nature of goods
 - Same compensation reasonableness & approval requirements
- Reasonable contract or arrangement requirement expanded
 - New explicit disclosure requirements will apply to many, not all, service providers
 - Structural requirements (formal written agreement)
 - Contract must require fee & conflict disclosure including fee projections
 - Operational requirements
 - Service provider must actually comply with disclosure undertakings in the agreement

Proposed Regulation: Service Providers Subject to New Requirements

DOL: 408(b)(2)

- New explicit disclosure requirements will apply to:
 - ERISA fiduciaries
 - Investment Advisors Act fiduciaries
 - Other service providers (whether or not fiduciaries):
 - Covered services
 - Banking, consulting, custodial, insurance, investment advice, investment management, recordkeeping, brokerage or TPA services
 - Covered services + indirect compensation/fee
 - Accounting, actuarial, appraisal, auditing, legal or valuation
- Apply to services for all types of ERISA programs
 - includes insurer services to ERISA group health programs

Proposed Regulation: New Disclosure Requirements

DOL: 408(b)(2)

- Structural requirements
 - Agreement must be in writing
 - Contract to require written disclosure of all services & all fees for each service to best of provider's knowledge
 - Bundled services exception permits disclosure of bundled fee
 - Contract to require written disclosure of manner of payment (e.g., invoice or direct deduction)
 - Contract to require disclosure of any anticipated participation by provider in transactions, any anticipated conflicts & whether provider can influence its own compensation & any details of anti-conflict policies or procedures
 - Contract undertaking to provide information about material changes in disclosures within 30 days & to provide information plan requests for ERISA filings
 - Agreement must contain provider's representation that before contract executed the fiduciary with authority to cause ERISA plan to sign has in fact been provided with all such information
- Operational requirements
 - Service provider must comply with contractual disclosure undertakings

Form 5500 Changes

DOL: 5500

- Expanded annual report Form 5500 disclosures
 - Content
 - Expanded reporting of fees & services
 - Expanded reporting of contracting details
 - Timing
 - First wave of changes apply to 2007 5500s filed in 2008
 - Pending changes will apply to 2008 5500s filed in 2009 & 2009 5500s filed in 2010
 - Electronic filing
 - Required for 2009 forms filed in 2010
 - DOL intends to immediately post 5500s on DOL website
 - Should operate much like the SEC's Edgar system

Expanded Participant Disclosures

DOL: Disclosure

- DOL proposal to expand participant disclosures regarding fees & other investment information
 - Proposed 1/1/09 effective date
 - DOL's rationale based on an expanded reading of the duties of fiduciaries to supply information to participants
 - Extends rationale of participant "need to know" cases
 - DOL amicus brief in *Deere* case was a precursor
 - Applies to self-directed defined contribution plans
 - Not just 401(k) plans or plans relying on 404(c)

Practical Impact of New Service Contracting & Disclosure Standards

Impact

- Service arrangements will have to be renegotiated
 - Extent of the change depends on quality of current contracts
 - Arrangements not currently reflected in detailed written agreements will have to be reduced to writing
 - Effective date of §408(b)(2) reg will serve as the deadline
 - For 5500 consistency, 1/1/09 deadline remains likely
 - Proposed effectiveness 90 days after final reg
 - Depending on complexity of plan sponsor's governance practices, it may soon be too late for full compliance by anticipated effective date