

MetLife



Fiduciary-Level Disclosures For ERISA Retirement Plans

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About The Author

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¹ For current ratings information and a more complete analysis of the financial strength of Metropolitan Life Insurance Company and MetLife Insurance Company of Connecticut, please go to www.metlife.com and click on "About MetLife," "Ratings."

² As of June 30, 2011

³ LIMRA Terminal Funding and Single Premium Buyouts Survey-Second Quarter 2011

⁴ LIMRA Not-For-Profit Report, Q2 2011

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

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. However, the ability to determine reasonable compensation for plan services has historically been a difficult one, due to the lack of regulatory guidance. In recognition of this problem, on July 16, 2010, the DOL issued an interim final regulation on fiduciary-level fee disclosure that should help plan sponsors. It is expected that the DOL will release the final rule before year-end 2011.

Effective April 1, 2012, the interim final regulation on fiduciary-level fee disclosures (alternatively referred to as the “408(b)(2) regulation”) generally requires certain companies that provide services to ERISA employee pension benefit plans to disclose the direct and indirect fees charged 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 new DOL interim 408(b)(2) regulation and how it affects your role as a plan fiduciary.

Historically, there has been little guidance for plan sponsors.

Background

In recent years, the DOL has issued fee disclosure rules and regulations in three separate phases covering both plan sponsor and participant level disclosures. These regulations have increased the types and detail of required disclosures as follows:

Phase One: Effective for the 2009 plan year, the DOL amended the ERISA 5500 Schedule C rules by requiring plan sponsors to annually report additional details on compensation received by pension and welfare plan service providers.

Phase Two: On July 16, 2010, the DOL issued the 408(b)(2) interim final regulation which provides that no contracts or arrangements for services between a pension and profit sharing plan and a covered service provider will be considered reasonable under ERISA unless all disclosure requirements of the regulation are met.

Phase Three: On October 20, 2010, the DOL published final regulations that require plan administrators to disclose certain fee and investment information to participants and beneficiaries in ERISA participant-directed individual account plans, such as 401(k) and 403(b) plans. This new rule includes uniform fee and investment performance disclosure requirements.

408(b)(2) Fee Disclosure Interim Final Regulation

Under ERISA, a contract or services arrangement between a service provider and a plan must be necessary for the establishment or operation of the plan 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).

As noted earlier, there was little guidance for plan sponsors to rely on to ensure they are complying with the “reasonable services” exemption. For this reason, the DOL determined that plan sponsors needed assistance to understand and evaluate fees charged by their retirement plan service providers. 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.

If the plan fiduciary fails to comply with ERISA Section 408(b)(2), the service arrangement will be treated as an ERISA prohibited transaction because the arrangement and fees are not considered reasonable. A prohibited transaction is a violation of the plan fiduciary's obligation to the plan, resulting in monetary penalties. The requirements of the 408(b)(2) regulation are independent of any other fiduciary obligations under ERISA.

Covered Service Providers

The 408(b)(2) regulation requires certain companies that provide services to ERISA pension and defined contribution plans, such as a 401(k) or ERISA 403(b) plan (e.g., a "covered plan"), to disclose the compensation the company receives for its services. Under the regulation, a covered plan does not include SEPs, simple retirement accounts and IRAs.

While most plan service providers are subject to the 408(b)(2) regulation, technically, only "covered service providers" need to comply. A "covered service provider" is a service provider that enters into a contract or arrangement with the covered plan and reasonably expects that it, or its affiliates or subcontractors, will receive \$1,000 or more in compensation in connection with providing specified services.

Specified services include:

- **Services provided directly to the covered plan as an ERISA fiduciary** or as a fiduciary to investment contracts or products that hold plan assets where the covered plan has direct investments.
- **Services provided directly to the covered plan as an investment advisor** (either the Investment Advisors Act of 1940 or under state law).
- **Recordkeeping or brokerage services** provided to a covered plan that is a participant-directed individual account plan, such as a 401(k) or ERISA 403(b) plan, and if one or more designated plan investments are available in connection with recordkeeping or brokerage services.
- **Services for indirect compensation** (i.e., compensation received from sources other than the plan, plan sponsor, covered service provider, affiliates, or subcontractors). The regulation provides a list of activities which constitute indirect compensation (including third party administration, auditing, actuarial and consulting services).

If the plan fiduciary fails to comply, the service arrangement will be treated as an ERISA prohibited transaction.

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.” A “responsible plan fiduciary” is a fiduciary with authority to cause the covered plan to enter into, or extend or renew, the contract or arrangement.

While the interim regulation defines what must be disclosed, the DOL has not prescribed a format for the way in which service providers must disclose information on fees and expenses, nor has it provided a safe harbor template. In addition, though the regulation’s disclosure must be in writing, it need not 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 Advisory Status:** If applicable, a statement that the covered service provider, an affiliate or subcontractor will provide, or reasonably expects to provide, services directly to the plan (or to an investment contract or product that holds plan assets, and in which the covered plan directly invests) as an ERISA fiduciary, or services directly to the plan as an investment advisor registered under either the Investment Advisors 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.
- **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 interim final 408(b)(2) regulation requires the identification of the payer and the services for which the indirect compensation will be received.
- **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, covered service providers are also required to provide additional information, including the following:

- **Recordkeeping** – The covered service provider must provide a description of recordkeeping services that are provided. There are special requirements that the covered service provider, an affiliate, or a subcontractor disclose any direct or indirect compensation that they reasonably expect to receive in connection with providing recordkeeping services. If there is no explicit charge for recordkeeping services (for example, recordkeeping is bundled with other services) 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.
- **Brokerage and Recordkeeping Services** – For recordkeeping or brokerage services provided in connection with offering designated plan investment alternatives, certain investment-related fees and expenses for each investment alternative must be disclosed. Examples include sales loads, sales charges, redemption fees, surrender charges, exchange fees, and annual operating expenses (e.g., expense ratio) if the return is not fixed.
- **Investment Fiduciaries** – The covered service provider must disclose certain investment-related fees and expenses for fiduciary services provided directly to certain investment vehicles or investment products that hold plan assets and in which the plan directly invests. Duplicate disclosures are not required if disclosed as part of recordkeeping or brokerage services disclosure.

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 disclose to the responsible plan fiduciary the information reasonably in advance of the date the contract is entered into, extended or renewed. For outstanding contracts on the effective date of the regulation, the information must be disclosed by the effective date, which is April 1, 2012.

For a new investment option, 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. Under the current 408(b)(2) regulation, there is no materiality standard as to what type of modification requires disclosure.

Plan fiduciaries will be protected from certain prohibited transaction liability.

Upon Request – If the responsible plan fiduciary requests 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 no later than 30 days following the receipt of a written request. If there are extraordinary circumstances beyond the control of the covered service provider that precludes 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 a 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. The DOL has developed a sample Delinquent Service Provider Disclosure Notice that is available on their website at www.dol.gov. The notice may be sent electronically to OE-DelinquentSPnotice@dol.gov.

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 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 such error or omission.

Final Fiduciary-Level Regulation

As mentioned earlier, this is an “interim” DOL regulation. Since the time the interim fiduciary-level regulation was issued by the Department in July 2010, the DOL has requested and received many comments. The final regulation is expected to be released before year-end 2011. This final regulation could both clarify and/or change the current guidance, and MetLife will communicate the relevant and important changes to its customers. At this time, we cannot anticipate how significant any changes from the interim regulation might be.

Analyzing Plan Fees

Plan fiduciaries should remember that reasonable cost does not necessarily mean the lowest cost. There may be other benefits received by the plan sponsor and/or participants that are more qualitative in nature and should be considered during an analysis. Examples of such 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 information provided by the service provider should facilitate a more complete analysis of plan costs. The new DOL regulation underscores that plan management activity is an important component in complying with overall ERISA responsibilities.

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New rules require plan sponsors to disclose and explain related fee and investment information to their plan participants.

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 new disclosure requirements are intended to enable plan fiduciaries to fulfill these responsibilities.

MetLife understands the need for fee disclosure and supports the intent of the new regulation. Service providers across the industry must now provide sufficient detail so that plan fiduciaries can analyze fees. In mid-2012, this will become even more important because of new rules which require plan sponsors to 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 should serve as helpful reminders 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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