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DOL Issues Final Fee Disclosure Rule

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On February 3, 2012, the Department of Labor (DOL) published a final regulation governing the disclosure of fees by persons or entities providing services to retirement plans governed by ERISA. See Treas. Reg. § 2550.408-2; 77 Fed. Reg. 5632 (Feb. 3, 2012). This regulation details the disclosures that a covered service provider must furnish to a covered plan fiduciary before that fiduciary may enter into or extend contracts for services to the plan. Under a prohibited transaction class exemption previously issued by the DOL, if the fee disclosure requirements are not satisfied, the expenses associated with the contract or service arrangement will not be treated as exempt from ERISA's prohibited transaction rule and may be subject to excise taxes. The effective date of the service provider disclosure rule is extended to July 1, 2012.

The disclosure requirements apply to any covered service provider with respect to: (a) a defined benefit or defined contribution pension plan subject to ERISA or a "plan asset" vehicle in which the plan invests; (b) an investment advisor registered under state or federal law; (c) a recordkeeper or broker who makes investment alternatives available to the plan; and (d) a provider of services to the plan who receives "indirect compensation" for such services (including accounting, auditing, actuarial, banking, consulting, custodial, insurance, investment advisory, legal, recordkeeping, securities brokerage, third party administrators, or valuation services). A service provider is covered if it reasonably expects to receive fees of at least \$1,000. The disclosure rule does not apply to simplified employee plans (SEPs), SIMPLE retirement accounts, IRAs and certain "frozen" annuity contracts and custodial accounts established under Internal Revenue Code section 403(b). In addition, the disclosure requirements do not yet apply to welfare benefit plans, so, for example, no fee disclosures are yet required to the fiduciaries of health plans from third-party administrators or insurance companies.

These disclosure requirements generally apply, for example, to direct compensation that a 401(k) plan pays to its recordkeeper or investment advisor, including any investment management fees deducted directly from the investment funds themselves and any indirect fees that the investment manager might pay as revenue sharing with a recordkeeper. The regulation would also require a disclosure of an investment manager's "float," as indirect compensation. Further, any indirect compensation paid by a third-party pension plan administrator to the plan's actuary would have to be disclosed as indirect compensation. The costs of so-called "bundled" services provided to a qualified retirement plan must be broken out separately.

The Final Regulation Requirements

The specific disclosure requirements, as modified by the final regulation, include:

- A description of the services to be provided to the plan in a clear and understandable manner. The level of detail required may vary depending upon whether the parties to the contract already understand the nature of the services. Disclosures of changes in **investment-related** information must be provided "at least annually," a more workable requirement from the 60-day period set forth in the proposed regulation. All changes to information **not** related to investment information (such as the description of the services to be provided, the amount of compensation to be received, the cost of recordkeeping, etc.) are required to be disclosed within 60 days from the date on which the service provider is informed of the change.
- If applicable, a statement that the covered service provider, an affiliate, or subcontractor reasonably expects to provide services under the contract to the plan as a fiduciary; and a statement that the covered service provider, an affiliate, or a subcontractor reasonably expects to provide services as a registered investment advisor to the plan.
- A description of all direct compensation (e.g., compensation received directly from the plan) expected to be received and a description of all indirect compensation (e.g., compensation received from any source other than the plan, plan sponsor, covered service provider, or its affiliates or subcontractors) expected to be received. The description of indirect compensation must also include a description of the arrangement between the payer and the service provider.
- Where applicable, investment-related fee disclosures may be provided in the form of the investment alternative issuer's own current disclosure materials, or information replicated from such materials, regardless of whether the disclosure materials themselves are regulated, provided that the issuer is regulated, and the service provider acts in good faith, does not know that the materials are incomplete or inaccurate, and provides no representations as to the accuracy and completeness of such materials. This is helpful for service providers who provide recordkeeping or brokerage services that include designated investment alternatives independently selected by the plan fiduciary (e.g., "off-platform" investment alternatives). See 77 Fed. Reg. 5632, 5640 (Preamble to Final Regulation Section B(4)(f)).
- If the service provider cannot otherwise describe the compensation or cost required to be disclosed, the service provider may provide reasonable and good faith estimates. The descriptions may be expressed in dollar amounts, formulae, percentages, per capital charges or other reasonable methods.
- A disclosure of an investment fund's annual operating expenses expressed as a percentage of total annual operating expenses, as well as other information relating to such investments that is within the control or reasonably available to the service provider and is a required disclosure under the rule for participant-directed investments under ERISA section 404(c).
- All compensation paid on a transaction or incentive basis (e.g., commissions) or charged directly against plan investments.
- Compensation paid in connection with the termination of the contract or arrangement.
- The manner in which compensation will be paid.
- Specific disclosure requirements for fiduciaries to plan asset funds (e.g., investment managers) and recordkeepers and brokers who provide one or more investment options to plan participants through a platform.

The information must be provided to the responsible plan fiduciary in writing reasonably in advance of entering into, extending, or renewing a contract or service arrangement with that provider. The rule does not require a particular format for the required disclosures, which may be contained in a single document or in multiple documents. The final regulation provides a Sample Guide that can be used voluntarily by service providers to summarize where the required initial disclosures are to be found in multiple documents.

Ongoing obligations of covered service providers under the rule include the duty to notify the responsible plan fiduciary of any change to the initial disclosures as soon as practicable, but no later than 60 days after the service provider is informed of the change (annually in the case of investment-related information as explained above). In addition, a covered service provider must disclose compensation or other information requested by the responsible plan fiduciary or plan administrator necessary to comply with ERISA reporting and disclosure requirements. As

explained, this disclosure must be made reasonably in advance of the date upon which the plan fiduciary states that it must comply with the applicable reporting requirement under the final rule.

In addition, the plan fiduciary has the ongoing obligation to notify the Department of Labor of any disclosure failures by a covered service provider that are not corrected within certain timeframes. If a service provider fails to disclose required information, the plan fiduciary must request the information in writing. If the service provider fails to comply within 90 days of the written request, the plan fiduciary must decide whether or not to terminate the contract or arrangement. The plan fiduciary must also notify the Department of Labor of the covered service provider's failure to comply. This notice must contain certain specific information listed in the final rule and must be forwarded to the Department of Labor no later than 30 days after the earlier of: (1) the covered service provider's refusal to provide the requested information; or (2) 90 days after the written request is made.

Under the prohibited transaction class exemption, if a service provider fails to disclose required information, the plan fiduciary must request the information in writing from the service provider. If the service provider fails to comply within 90 days, the plan fiduciary must decide whether or not to terminate the contract or arrangement. The interim rule has been modified in the final regulation to emphasize that determinations by the plan fiduciary in this regard must be made in accordance with the prudence standards of section 404 of ERISA. Thus, if the information relates to future services and is not promptly disclosed within 90 days, the plan fiduciary must terminate the service arrangement "as expeditiously as possible," consistent with its duty of prudence.

Lastly, the final regulation extends the deadline for providing participant disclosures. For calendar year plans, the initial disclosure of plan and investment-related information must be made by August 30, 2012. The first quarterly statement must be provided to participants by no later than November 14, 2012, and must reflect expenses only during the third quarter.

Next Steps

Many vendors have updated or are in the process of updating their service agreements and materials to incorporate the final rule. The plan fiduciaries under the rule, however, should not accept these contracts at face value. While vendors will likely develop the means of complying with the final regulation, plan fiduciaries are advised to establish a checklist and timeline, either on their own or by means of negotiating representations and other provisions in vendor contracts, to ensure:

- the sufficiency and accuracy of the information received from the service provider pursuant to the final regulation;
- timely receipt of all information, including any changes to previously provided information;
- timely requests to service providers for required information, especially with respect to any indirect compensation;
- a format and disclosure language that is understandable to the plan participant population involved;
- appropriate notice and action if the information is not timely provided or is deficient;
- appropriate indemnifications with respect to timely compliance; and
- appropriate documentation of the receipt of the information, the fiduciaries' consideration of it, and any actions taken.

In addition to the final regulation itself, the DOL has published a fact sheet regarding the final regulation and a list of changes to the final fee disclosure rule.

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