



For your information

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DOL Releases Final Service Provider Fee Disclosure Regulations

The DOL issued long-awaited ERISA Section 408(b)(2) final regulations. The final regulations are effective July 1, 2012.

Background

The Employee Retirement Income Security Act of 1974 (ERISA) generally prohibits the provision of goods, services, or facilities between an employee benefit plan and a party in interest. ERISA Section 408(b)(2) exempts certain contracts or arrangements for essential services between service providers and plans if the arrangement and the compensation for services are “reasonable.”

In December 2007, the Department of Labor (DOL) issued proposed regulations on what constitutes a reasonable arrangement under ERISA Section 408. In addition, the DOL issued a proposed class exemption that would provide relief to plan fiduciaries when service providers fail to meet their disclosure obligations. (See our January 3, 2008 [For Your Information](#).)

In July 2010, the DOL published interim final regulations that made significant changes to the 2007 proposed regulations. (See our September 2, 2010 [For Your Information](#).) The interim final regulations required covered service providers (CSPs) to provide detailed disclosures of certain direct and indirect compensation received by them, their affiliates, and their subcontractors. Direct compensation is compensation received directly from the plan. Indirect compensation is any compensation received from any source other than the plan, the plan sponsor, a CSP, or a CSP’s affiliates or subcontractors. Among other things, the interim final regulations required CSPs to disclose the identities of the parties from whom they directly or indirectly receive fees or other compensation in connection with plan services and other potential conflicts of interest.

DOL Final Regulations

The DOL issued [Section 408\(b\)\(2\) final regulations](#) (final regulations). Generally, the final regulations, which supersede the July 2010 interim final regulations, retain the basic structure of the proposed and interim final regulations by requiring that CSPs satisfy certain disclosure requirements to qualify for the statutory exemption for services under ERISA Section 408(b)(2). However, in the final regulations, the DOL makes the following notable changes to the interim final regulations.

Covered Plans

The final regulations, like the interim final regulations, provide that no contract or arrangement for services between a covered plan and a CSP, including extensions or renewals, is reasonable within the meaning of ERISA Section 408(b)(2) and the final regulations unless the terms of the final regulations are satisfied.

In the final regulations, the DOL amends the interim final regulations to provide that certain Internal Revenue Code (IRC) Section 403(b) annuity contracts and custodial accounts are excluded from the types of pension plans covered by the final regulations. Specifically, such contracts and accounts are excluded if:

- The contract or account was issued to a current or former employee before January 1, 2009;
- The plan sponsor is no longer obligated to make contributions;
- The sponsoring employer stopped making contributions for periods before January 1, 2009;
- The rights or benefits of individual owners of the contracts or accounts are enforceable against the insurer or custodian without employer involvement; and
- The individual owners are fully vested in benefits provided under the contract or account.

INSIGHT

By excluding certain ERISA Section 403(b) accounts and contracts, the DOL accepts the recommendations of commenters who argued that annual reporting requirements will have little impact on “frozen” contracts and accounts given the sponsor’s limited ability to modify these arrangements.

Initial Disclosure Requirements

The following changes were made to the initial disclosure requirements.

Disclosure of Compensation. Under the final regulations, a CSP must provide comprehensive information about the compensation it will receive in connection with services provided pursuant to the contract or agreement. The final regulations enhance the requirements with respect to disclosure of indirect compensation. Specifically, under the final regulations, a CSP must not only identify the payer of the indirect compensation but also describe the arrangement between the payer and the CSP pursuant to which indirect compensation is paid.

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The DOL, in the preamble to the final regulations, makes clear that it intends for the concept of compensation received by a CSP in connection with a particular

contract or arrangement to be construed broadly. For example, if a financial institution that a CSP may recommend to a plan subsidizes the CSP's client conference, then the CSP should detail the subsidy as compensation received "in connection with" the plan.

Summary/Guide. The final regulations reserve a paragraph for the future requirement of a summary or guide that would help a responsible plan fiduciary (RPF) locate compensation disclosures that may have been provided in many different documents the CSP provides to the RPF. To encourage CSPs to provide a summary or guide before the proposed regulation is published, the final regulations include a "sample guide" to initial disclosures as an appendix.

Timing of Disclosures. The final regulations leave unchanged the rule that disclosures be provided reasonably in advance of when a contract or agreement is entered into, extended, or renewed. The final regulations still set a deadline of 60 days (from the date the CSP is informed of the change) for disclosure of changes to previously disclosed information. However, the DOL recognized that this could be impractical for investment information given the potentially large number of nominal changes. Therefore, the final regulations only require annual disclosure of investment-related information.

Investment-Related Disclosures

The final regulations also make the following changes to the investment-related disclosure requirements.

Fiduciary Services. The final regulations require additional investment disclosures from certain CSPs. Under the final regulations, a CSP providing fiduciary services pursuant to an investment contract, product, entity, or service in which the covered plan has a direct equity interest must disclose the total annual operating expenses for designated investment alternatives (DIAs), expressed as a percentage and calculated in accordance with the participant-level individual account plan disclosure regulations.

INSIGHT

The preamble makes clear that this disclosure is the primary responsibility of the fiduciary service provider. However, these service providers can arrange for the plan recordkeeper to provide this information to avoid duplicative disclosure.

In addition, the final regulations require disclosure of any other information relating to DIAs that is within the control of or reasonably available to a CSP if the information is considered investment-related information which must be provided automatically under the participant-level individual account plan disclosure regulations.

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This requirement may have an impact on the ERISA fiduciaries for collective investment trusts who have not calculated average annual returns and total annual operating expense ratios in compliance with ERISA's participant-level fee disclosure requirements but instead relied on other third parties (e.g., plan recordkeeper or trustee) to do so.

Recordkeeping and Brokerage Services. Under the final regulations, CSPs providing recordkeeping or brokerage services to an individual account plan can comply with requirements for investment-related disclosures relating to DIAs by providing the issuer's current disclosure materials or information replicated from such materials. The issuer of the DIA must be unaffiliated with the CSP and be one of the following:

- An insurance company qualified to do business in a state
- An issuer of a publicly-traded security
- A registered investment company
- A financial institution supervised by a state or federal agency.

The CSP must act in good faith and not know that the materials are incomplete or inaccurate. In addition, the CSP must furnish the RPF with a statement that the CSP makes no representations as to the completeness or accuracy of the materials.

The regulations make clear that a CSP can provide information from an affiliated entity but that it will then be responsible for the content of that information.

Reporting and Disclosure Information

In the final regulations, the DOL changes the deadline for providing reporting and disclosure (R&D) information to an RPF on written request. Service providers must now provide this information to the RPF "reasonably in advance of the date upon which" the RPF or covered plan administrator states that it must comply with the applicable R&D requirements (e.g., completing Form 5500). Under the interim final regulations, the deadline was tied to the date of the request. However, if timely disclosure is beyond the CSP's control, the information must be disclosed as soon as practicable.

Disclosure Errors

Under the final regulations, a disclosure error or omission will not cause the contract or arrangement to violate the final regulations if a CSP corrects the disclosure as soon as practicable, but not less than 30 days from the date on which the CSP knows of the error or omission. The final regulations cover errors and omissions relating both to the initial disclosures and to any subsequent changes.

Definition of Compensation

The final regulations expand the definition of compensation to include the cost of providing a service. In the final regulations, the DOL makes clear that “compensation” includes, for example, compensation for recordkeeping services and the cost of recordkeeping services. This will be particularly relevant to CSPs of recordkeeping services who did not previously separate the cost of recordkeeping from their bundled service offering. In addition, under the final regulations, the definition of “compensation” allows for a “reasonable and good faith” estimate of compensation or cost if the CSP cannot readily describe the compensation or cost. However, the CSP must explain the methods and assumptions used in preparing the estimate.

Exemption for RPFs

To avoid engaging in a prohibited transaction under ERISA Section 408(b)(2), a RPF, on discovering that a CSP failed to disclose certain required information, must request the information in writing from the CSP. Under the final regulations, if the CSP fails to respond to the written request within 90 days, the RPF must decide whether to terminate or continue the contract or arrangement consistent with its duty to act prudently. If the information relates to future services and the CSP fails to respond to the RPF’s written request within 90 days, under the final regulations, the RPF must terminate the service arrangement as quickly as possible consistent with its duty to act prudently.

COMPLIANCE ALERT

RPFs should consult the DOL’s website regarding [fee disclosure failure notices](#). The DOL is currently developing the online filing system for such notices and provides that the system will be available before the date needed to comply with the exemption.

Effective Date

Service providers must be in compliance with the final regulations by July 1, 2012 with respect to new and existing contracts and arrangements between ERISA-covered plans and service providers.

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The effective date was originally April 1, 2012. The extended period for compliance gives CSPs more time to comply with changes in the final regulations. In addition, because the effective date of the participant fee disclosure regulations was set as 60 days after the effective date for the Section 408(b)(2) rules, the initial annual disclosures under the participant-level fee disclosure regulations are now required no later than August 31, 2012. The rules

governing quarterly participant fee disclosure are now required no later than November 15, 2012.

Conclusion

Although the final regulations contain some notable changes, generally they do not represent a dramatic departure from the interim final regulations. Nonetheless, service providers and plans must work quickly to update contracts and arrangements to reflect the requirements in the final regulations. Buck's consultants are available to help.

Buck Can Help

- Determine which vendors are considered CSPs and help ensure they provide all required disclosures
- For a defined contribution plan that never separately received an estimate of recordkeeping costs, review the estimate for reasonability in light of Buck's experience working with comparable plans

This FYI is intended to provide general information. It does not offer legal advice or purport to treat all the issues surrounding any one topic.
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