Service Provider Fee Disclosure
Rules Now Final: Next Steps for Retirement Plan Fiduciaries

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Service Provider Fee Disclosure Final Rules

The Department of Labor (DOL) published final service provider fee disclosure rules under Section 408(b)(2) of the Employee Retirement Income Security Act (ERISA) on February 3, 2012. The rules address the information that a retirement plan service provider must give to the plan’s fiduciary regarding the fees and other forms of compensation that the service provider expects to receive for contracted services. These new final rules include several changes from the interim rules that the DOL published in July 2010. The rules are intended to enable plan fiduciaries to receive the information they need to make meaningful evaluations as to the reasonableness of the service provider fees paid by retirement plans and their plan participants.

Background

In recent years, the DOL has taken a number of steps to increase transparency around fees, expenses and other amounts that are charged against the assets in retirement plans. The focus of this initiative is to make more useful information available to plan fiduciaries (and plan participants) about such fees. The expectation is that plan fiduciaries will find it easier to determine what fees are reasonable and will be in position to discern whether an arrangement with a service provider includes any conflicts of interest. Each of these obligations is a fundamental part of the fiduciary’s duty to the plan. The new final rules may have a substantial impact upon how these fiduciary obligations will be met in the future, particularly for plans that include participant investment direction.

This Aon Hewitt report begins with a summary of the changes to the interim final rules that are now in the new service provider fee disclosure regulation. Next is an outline of the steps plan fiduciaries and service providers should consider to assure that their fee arrangements comply with the new rules. Finally, we provide an overall summary of the provisions of the fee disclosure regulation.
Significant Clarifications and Changes

The new final rules regarding service provider fee disclosure retain the basic structure and content of the July 2010 interim final rules. However, there are a number of notable changes and clarifications.

Covered Plans. The fee disclosure rules generally apply to retirement plans that are subject to Title I of ERISA. For example, certain 403(b) and 457 plans offered by governmental and church-affiliated entities are not subject to ERISA and are not covered by these fee disclosure rules. Similarly, the DOL clarified that the fee disclosure rules do not apply to a plan that exclusively covers an owner and his/her spouse (and does not include any employees). An additional exclusion was added in the final rule for certain frozen 403(b) accounts and annuities which are otherwise subject to ERISA. This exclusion is limited to 403(b) accounts and annuities for which the employer ceased to have an obligation to make contributions for periods before January 1, 2009, and ceased making such contributions for periods before that date.

Covered Service Providers. Four categories of service providers are covered under the final rules: 1) fiduciaries, 2) registered investment advisers, 3) recordkeepers or brokers who make investment alternatives available to a plan, and 4) other specified service providers who reasonably expect to receive “indirect compensation.” These four groups are required to make the disclosures described in the rules. The final rule clarifies that an affiliate of a covered service provider would not itself be deemed a covered service provider solely due to that affiliation and only one service provider would need to furnish disclosures for a “bundled” service arrangement involving multiple service providers under a single contract or arrangement. Also, the DOL did not accept the suggestion that every covered service provider be required to state whether it is or is not acting as a fiduciary. Fiduciary status is determined based on a factual analysis of services performed. A covered service provider that renders investment advice is obliged to confirm that fiduciary status in its disclosures.

Expanded Disclosure of Indirect Compensation. A covered service provider must separately disclose any compensation expected to be received from third parties. The interim rule required that for indirect compensation disclosure, the payer and payee be identified. The final rule adds an additional requirement to the disclosure regarding such third-party “indirect” compensation. The service provider also must describe the relationship or the arrangement it has with the third party that will be paying compensation. This requirement is designed to illustrate for the plan fiduciary where any potential conflicts of interest might exist. (The requirements for disclosure of compensation paid among related parties already required disclosure of the relationship.)

Recordkeeping Fees Must be Stated or Estimated. Under the fee disclosure rules, a provider of recordkeeping services is generally required to disclose all direct and indirect compensation that it reasonably expects to receive in connection with such services. The final rule clarifies that disclosure is also required for the “no fee” recordkeeping services that may be included as part of a bundle or package of services. To the extent that recordkeeping services are provided without explicit compensation for such services, or are offset or rebated based on other compensation, the service provider must nonetheless give a reasonable, good faith estimate of the cost to the covered plan of such recordkeeping services, including an explanation of the methodology and assumptions used to prepare the estimate.

Investment-related Disclosures. The DOL previously published separate rules that require the plan administrator of a 401(k) plan (or certain other individual account plans with participant-directed
investments) to disclose specific information to plan participants about plan fees and expenses. The final service provider rule aligns the investment-related disclosures required to be made by the service provider with the investment-related disclosures that must be provided to plan participants for designated investment alternatives. The DOL clarified that only certain fee information (e.g., fees that may be charged to a participant’s account for certain transactions) needs to be provided for a plan brokerage window or self-directed brokerage account.

**Estimated Compensation.** The definition of compensation under the service provider rules was revised to clarify that estimated compensation could only be used if compensation cannot otherwise be reasonably described. If estimated compensation is given, the estimate must include the methodology and applicable assumptions applied, to ensure that the plan fiduciary has sufficient information to determine that the compensation is reasonable.

**Guide to Disclosures.** The DOL has not mandated any particular form or format be used by a service provider to make the required disclosures. The final rule includes a sample guide that a service provider could complete as a “roadmap” for the plan fiduciary to the various materials that comprise the disclosures. The sample guide, while not required, may represent a sensible approach for a service provider to take to facilitate the plan fiduciary’s agreement that the disclosure is complete. (The responsible plan fiduciary has the right and the obligation to assure that it has received all of the information required by the rules.) The sample guide also may encourage consistency and lower compliance costs. The DOL has indicated that they will seek additional comments on this topic and may require a guide or similar tool in the future.

**Timing of Updates to Disclosures.** Errors and omissions in previously disclosed information must be corrected as soon as practicable, and no later than 30 days from the date on which the service provider learns of the error or omission. If previously disclosed information changes, it must be updated as soon as practicable but not later than 60 days from the date of when the covered service provider is informed of the change, absent special circumstances. The final regulations provide an exception to this rule for investment-related information. The DOL was persuaded that the 60-day standard as applied to investment information might be burdensome and generate undue volumes of information. Under the final rule, updates to investment-related information must be made “at least annually.”

**Timing of Responses to Plan Reporting Requests.** The interim final rule required a service provider to respond within 30 days to a plan administrator’s request for information necessary to comply with the plan’s reporting and disclosure requirements. The final rule abandons that time frame and states that the information must be disclosed reasonably in advance of when the plan administrator is required to meet the particular obligation that caused the request.

**Exemption From Prohibited Transaction Sanctions for Plan Fiduciaries.** The final rule includes the prohibited transaction exemption for plan fiduciaries that was separately stated as a class exemption in the interim rules. If a service provider fails to meet the disclosure obligation, this exemption is available to the plan fiduciary if certain conditions are met. The final rule also clarifies that a plan fiduciary is expected to terminate the relationship with the uncooperative service provider “as expeditiously as possible, consistent with the duty of prudence.” The final rule does not contain a similar prohibited transaction exemption for a covered service provider. However, if a service provider discloses compensation in good faith and exercises reasonable diligence in its disclosures, an error or omission will not result in a

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1 DOL Regulation § 2550.404a-5
prohibited transaction if the disclosure is corrected within 30 days after discovery of such error or omission.

**Pass-Through Liability Relief for Recordkeepers and Brokers Expanded.** The interim final rule relieved the 401(k) recordkeeper or broker from responsibility for the accuracy of underlying investment-related information disclosed for plan investment funds if the recordkeeper passed through regulated documentation from a nonaffiliated investment provider. The final rules now allow the service provider to pass along materials from the investment issuer, or information taken from such materials. The revised rule focuses on whether the issuer of the materials (not the materials themselves) is regulated.

**Compliance Deadlines Extended.** The DOL extended by three months the deadline for plan fiduciaries and covered service providers to comply with the new service provider fee disclosure rules. The prior deadline (April 1, 2012) has been extended to July 1, 2012. Consequently, service provider fee disclosures for existing contracts must be made before July 1, 2012, in order to permit the plan fiduciaries to properly assess the reasonableness of the service provider fees. These disclosures must be made before entering into or extending a contract on or after that date. The service provider disclosures will comprise a significant portion of the fee disclosures to be made to participants and beneficiaries in individual account plans. The initial participant fee disclosures are due no earlier than 60 days after the effective date for the service provider disclosures. For calendar year plans, that deadline is August 30, 2012. (Certain fiscal year plans will have a later deadline.) The initial quarterly statements for calendar year plans must follow within 45 days of the close of the next quarter end, specifically, by November 14, 2012.

**Next Steps for the Plan Fiduciaries**

The service provider fee disclosure must be made to the plan fiduciary that is responsible for making decisions about services for the covered plan. In order to be appropriately prepared for the July 1, 2012 effective date, the responsible plan fiduciary of a covered plan will need to:

- Evaluate whether the various plan service providers qualify as covered service providers under the final rules. (The categories are fiduciary, investment adviser, broker/recordkeeper for an individual account plan with designated investment alternatives, and other specified providers that expect to receive indirect compensation.)

- Confirm with these service providers that they agree that they are covered by the regulations and will make arrangements for the disclosures to be delivered on a timely basis. Otherwise, come to a timely resolution of any disagreements.

- Address service provider fee disclosure obligations when entering new contracts or extending existing contracts prior to the July 1, 2012 effective date. Consider including specific provisions in written service agreements that require the service provider to comply with the disclosure rules, including updates to prior disclosures and correction of previous disclosure errors or omissions, so that contractual remedies are available in the event of a failure to disclose. Also, the service agreement should include a provision defining the conditions upon which a contract will be terminated if the service provider fails to make the necessary disclosures, updates, or corrections.

- Consider asking all service providers to disclose whether they will receive compensation from third parties or any forms of revenue from related parties in connection to the services they are providing to the plan.
Confirm or develop a plan governance process to provide for fiduciary review of the reasonableness of service provider fees in light of the information included in the disclosures received. Consider benchmarking service provider fees against fees of similar service providers for comparable plans, with particular focus on participant-borne fees. Document determinations of reasonableness or undertake efforts to resolve reasonableness concerns.

For any individual account plan for which participant fee disclosure is required, develop the disclosures for participants and beneficiaries under the plan. Coordinate composition and distribution of notices with bundled service providers, namely plan recordkeepers.

Confirm with all investment providers that the necessary investment fund fee information will be made available to recordkeepers and brokers of participant-directed individual account plans for the participant disclosure.

Consider an annual review of plan fees, which may require additional service provider disclosures, in order to determine the impact of fees on the plan over time.

Service Provider Fee Disclosures—The Rules

The regulations state that no contract or arrangement between a covered plan and a covered service provider will be considered “reasonable” unless the service provider fee disclosure requirements are met. Disclosures must be made to the responsible plan fiduciary before the service provider is initially selected or a prior arrangement is extended or renewed. The following summary contains a more detailed description of the new rules.

ERISA Rules

The new rules impose several requirements on ERISA plans with respect to the selection of and compensation paid to service providers:

- First, plan fiduciaries have a duty to act prudently and solely in the interests of plan participants and beneficiaries when selecting and monitoring plan service providers and investments. These duties require a fiduciary to evaluate whether compensation paid to a service provider by a plan (as opposed to the employer) or plan participant is reasonable.
- Second, ERISA provides that it is a “prohibited transaction” when a plan pays a service provider unless the payment is for necessary services and only reasonable compensation is paid by the plan. Both parties (i.e., the service provider and the fiduciary who approves the arrangement with the service provider) are subject to excise taxes and penalties under ERISA and the Internal Revenue Code (the Code) if the arrangement is a prohibited transaction.

The final rules are intended to ensure that plan fiduciaries have the information they need to determine that service provider compensation is reasonable, and, therefore, that contracts or arrangements with service providers are reasonable. Additionally, the rules will help plan fiduciaries identify potential conflicts of interest.

Covered Plans

The plans subject to the disclosure rules include “pension plans” as defined under Section 3(2) of ERISA. Both defined benefit and individual account plans are covered, although certain rules apply only to participant-directed individual account plans.
Plans exempted from ERISA coverage (i.e., government and church plans, certain 403(b) and 457 plans) generally are exempt from these rules. A 403(b) plan that is subject to ERISA will be covered by the disclosure rules; however, there is a limited exception for certain 403(b) annuity contracts and custodial accounts that were created before January 1, 2009. Simplified employee pension plans, simple retirement accounts, and individual retirement accounts are specifically exempted from the disclosure requirements. Plans or accounts that are not subject to ERISA (for example, a Keogh plan that covers only partners or a sole proprietor, or a health savings account) are not subject to these rules. Generally, unfunded nonqualified plans are not covered.

Welfare plans are not subject to the regulations. However, the DOL indicated that service provider fee disclosure rules for welfare plans are expected to be issued in the future.

Covered Service Providers

Many service providers are not required to comply with these fee disclosure rules. Some service providers (e.g., actuaries, attorneys, and consultants) are only covered service providers if they reasonably expect to receive indirect compensation. Others, such as commercial printers or providers of distribution or other fulfillment services, simply do not have disclosure obligations under these rules. Note, however, the compensation for the services of an affiliate of a covered service provider must be disclosed by the covered service provider, even if the affiliate’s services would not otherwise be reportable. Moreover, the party that enters into a contract that includes covered services is the covered service provider responsible for making the required disclosures, even if related parties will perform some or all of the covered services.

Certain requirements also apply to covered defined benefit plan service providers. Some service providers (e.g., fiduciaries) to defined benefit plans must make the required fee disclosures. However, these rules will not apply to many nonfiduciary defined benefit plan service providers. For instance, recordkeepers and brokers for defined benefit plans (in addition to actuaries, accountants, and others) are not covered service providers if they do not receive indirect compensation. Defined benefit plan recordkeepers and brokers also are not required to disclose fee information for plan investment options. An investment adviser for a defined benefit plan, however, is obliged to make fee disclosures to the extent the plan pays the fees.

In narrowing the categories of service providers that are required to disclose their compensation, the DOL noted its intent to focus on contracts or arrangements between plans and fiduciaries or other covered service providers that deal directly with the plans and that may receive indirect compensation or compensation from related parties. Covered service providers under these fee disclosure regulations will not necessarily be the same providers that must report compensation for purposes of the Schedule C to the Form 5500 Annual Report. The DOL does not believe that it is appropriate for every service provider to be subject to these rules. However, certain providers with complex fee arrangements, or that by the nature of their services have the potential to influence plan fiduciary decisions, need to furnish more comprehensive disclosures.

Even if it would otherwise fall within the category of “covered service provider,” a service provider that does not reasonably expect to receive at least $1,000 in compensation (direct or indirect) under the arrangement does not have to provide disclosures under these regulations.
The regulations describe covered service providers as those that render services in the following three categories, with some exceptions:

**Services as a fiduciary or registered investment adviser, including:**

- Providers of services directly to a covered plan as a fiduciary, including providers of investment adviser services by a party registered under either the Investment Advisers Act of 1940 or under any state law.
- Plan asset fiduciaries (i.e., providers of fiduciary services to an investment contract, product, or entity (investment vehicle) that holds plan assets (based upon Sections 3(42) and 401 of ERISA and the DOL plan asset regulations) if the covered plan holds a direct equity investment in the investment vehicle). Fiduciaries of common collective trusts, separate accounts of an insurance company, and other investment vehicles not regulated under the Securities Exchange Act (with at least 25% of the assets held by benefit plan investors) would be plan asset fiduciaries and, therefore, covered service providers.
- In addition to fiduciary investment advisers, fiduciary service providers would include a plan’s trustee, investment manager, and any other provider that exercises discretionary authority over plan assets or plan management.

**Certain recordkeeping or brokerage services to participant-directed individual account plans.** If one or more designated investment alternatives will be made available through a platform or similar mechanism in connection with recordkeeping or brokerage services. Note, however, that because a brokerage window or self-directed brokerage account is not included in the definition of “designated investment alternative” (see Important Definitions found in this report), brokerage services that involve providing only a brokerage window or self-directed brokerage account for plan participants (and not any other investment alternative) would not cause a broker to be a covered service provider.

**Other services if there is a reasonable expectation of indirect compensation.** The following categories of service providers must disclose service provider fees if the providers or their affiliates or subcontractors reasonably expect to receive indirect compensation:

- Accounting;
- Auditing;
- Actuarial;
- Appraisal;
- Banking;
- Consulting (but only if related to the development or implementation of investment policies or objectives or assisting with the selection or monitoring of service providers or plan investments);
- Custodial;
- Insurance;
- Investment advisory (for plan or participants);
- Legal;
- Recordkeeping;

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2 29 CFR 2510.3-101.
- Securities or other investment brokerage;
- Third-party administration; and
- Valuation services.

For those service providers specified above, the plan fiduciary will always need to determine whether indirect compensation is received. However, many other providers of limited types of services, such as commercial printing or fulfillment, which are not services described in the rules, will not be covered service providers.

**Exceptions.** Only the service provider directly responsible for services to the covered plan is a covered service provider, even if some or all of the contracted services are provided by other parties. The regulations specifically exclude from the definition of covered service provider those persons or entities that render services solely in one of the following capacities:

- An affiliate or subcontractor that is performing one or more of the services to be provided under the contract or arrangement with a covered service provider.
- Service providers to an investment vehicle in which the covered plan invests, regardless of whether or not the entity holds plan assets (except for services as a fiduciary to an investment in which the covered plan has a direct equity investment). This would exclude an investment fund or other vehicle that does not hold plan assets and does not receive indirect compensation from services provided directly to a plan. Nonfiduciary service providers to common collective trusts and separate accounts of an insurance company also would be excluded.

**Initial Disclosure Requirements**

The covered service provider disclosures must be in writing. There is no requirement that the underlying contract or arrangement for services has to be in writing. Disclosures do not have to be in any specific format. They may be provided in a single disclosure document or multiple documents. If the disclosure does include multiple documents, the final rules include a sample guide that may be used to summarize the disclosure. While not required, the use of the sample guide (or other “roadmap” for the disclosures) is encouraged. The DOL notes that it will continue to review the question of how disclosure information should be presented to the plan fiduciary. Future guidance is to be expected.

The DOL intends for the disclosures to assist plan fiduciaries to understand the services provided and assess the reasonableness of the direct and indirect compensation and potential for conflicts of interest that may impact services. The substance of covered service provider disclosures must include the following specific information:

**Description of Services.** The covered service provider must furnish a description of all of the services that will be provided under the contract or arrangement. The description does not have to go into detail as to each subcategory of service that generally would be expected to be provided under a broader service category, such as “recordkeeping” or “brokerage.” However, the description should include sufficient information to enable the responsible plan fiduciary to determine whether the associated fees are reasonable. The regulations specify that a description of services of nonfiduciary service providers to an investment contract in which the covered plan invests does not have to be disclosed. This means, for instance, that services of an attorney or an accountant to a fiduciary investment entity would not have to be described.
The preamble to the final regulations notes that if plan fiduciaries need assistance in understanding any information furnished by the service provider, as a matter of prudence, they should request guidance from appropriate resources.

**Fiduciary Status.** The covered service provider must disclose whether it (or an affiliate or subcontractor) expects to perform services as a fiduciary, or as a registered investment adviser. A service provider is not obliged to affirmatively state that it is not a fiduciary (or adviser). Nonetheless, service providers that are not named fiduciaries should carefully consider whether they act as a functional fiduciary through the exercise of discretionary authority or control over plan management or plan assets. This may not always be clear. The disclosure of fiduciary status does not have to specifically state which services constitute fiduciary services. Nonetheless, a service provider may wish to distinguish which services are provided in its fiduciary capacity and which are not.

**General Compensation Disclosures.** There are four categories of compensation that must be disclosed. Covered service providers must disclose:

- **Direct Compensation.** All direct compensation that the covered service provider reasonably expects to receive from the covered plan in connection with services furnished under the contract or arrangement, including compensation received by its affiliates or certain subcontractors. Compensation paid by the employer need not be disclosed, if the employer is not reimbursed by the plan. If the employer is reimbursed by the plan trust for fees initially paid from the employer’s general assets, then the compensation paid to the service provider is direct compensation and must be reported.

- **Indirect Compensation.** All indirect compensation that the covered service provider reasonably expects to receive in connection with services under the contract or arrangement, including compensation received by its affiliates or certain subcontractors. The disclosure must describe the services for which indirect compensation will be received and must identify the person who will pay the indirect compensation. The disclosure also must describe the arrangement between the person that pays the indirect compensation and the service provider (or its affiliate/subcontractor) that will receive the payment. Indirect compensation is paid by third parties. For this purpose, a third party is a party other than the covered plan, plan sponsor, the covered service provider, and the covered service provider’s affiliates and subcontractors. Indirect compensation includes noncash compensation such as “soft dollars” or certain entertainment. Fees paid by the employer, which are not reimbursed by the plan, are not indirect compensation and need not be disclosed. The requirements to disclose indirect compensation and the arrangements that give rise to it are designed to illustrate to the responsible plan fiduciary the potential conflicts of interest resulting from receipt of indirect compensation.

- **Related Party Compensation.** Any compensation paid among a covered service provider and its affiliates and subcontractors ("related parties") with respect to services described under the contract or arrangement if the compensation is transaction-based (e.g., commissions, soft dollars, finder’s fees, or similar incentive compensation) or if the compensation is charged directly against plan assets and reflected in the net value of an investment option (e.g., 12b-1 fees). The services for which compensation will be paid also must be disclosed, as well as the payer and recipient (and their affiliate or subcontractor status). Disclosure of compensation paid among related parties is required even if it has been disclosed pursuant to one of the other disclosure requirements. (The compensation paid by an employer to an employee is not considered to be “related party compensation” and does not have to be included in this disclosure.) A common example of “related party compensation” occurs when investment and recordkeeping services are bundled. In such case, payments from the mutual fund of a related party to a recordkeeper or other related party will have to be disclosed if the compensation is paid from charges included in the fund’s expense ratio.
(e.g., 12b-1 fees). This requirement was added not only to enable plan fiduciaries to determine whether compensation is reasonable, but also to help plan fiduciaries identify potential conflicts of interest.

- **Contract Termination Compensation.** Any compensation that a covered service provider (and its affiliates or subcontractors) reasonably expects to receive in connection with the termination of the contract or arrangement. If any amounts are prepaid, this includes a description of how such amounts will be calculated and refunded at termination.

**Recordkeeping Services Compensation Disclosures.** The DOL believes that plan fiduciaries must receive information relating to recordkeeping in a meaningful way to allow plan fiduciaries to compare recordkeeping costs and services among providers, regardless of the type of service arrangement. In more complex bundled arrangements and where recordkeeping fees are not paid directly by the plan (e.g., paid through offsets or rebates), it can be difficult to determine the actual compensation paid and received for such services. Recordkeepers must disclose all direct and indirect compensation that the recordkeeper, and its affiliates and subcontractors, reasonably expect to receive in connection with the recordkeeping services. Providers are allowed to make reasonable and good faith estimates of recordkeeping costs as long as the methodology and assumptions used also are disclosed. Estimated compensation may be expressed in dollars, as a percentage of assets, a formula, a per capita charge, or any other reasonable method if none of the other methods will suffice. If the plan is not explicitly charged for recordkeeping services, the recordkeeping service provider must nonetheless provide a reasonable and good faith estimate of the cost to the plan of those services. This disclosure is designed to better enable plan fiduciaries to fulfill their obligation to determine whether the fees collected for bundled services are reasonable.

**Manner of Receipt of Compensation.** All of the general or recordkeeper disclosures must inform the plan fiduciary how compensation will be received. Specifically, the disclosure must state whether the plan will be billed for services or whether compensation will be deducted directly from a covered plan’s accounts or investments.

**Investment Option Disclosures by Fiduciaries, Recordkeepers, and Brokers.** Plan recordkeepers and brokers are now responsible to deliver fee information relating to the designated investment alternatives of individual account plans with participant-directed investments. Covered providers who are plan asset fiduciaries and plan recordkeepers and brokers to participant-directed individual account plans have parallel disclosure obligations with respect to a plan’s designated investment alternatives. These providers must disclose:

- A description of any compensation that will be charged directly against an investment for transactions relating to the purchase, sale, transfer of, or withdrawal from an investment option (e.g., sales loads, sales charges, deferred sales charges, redemption fees, surrender charges, exchange fees, account fees, and purchase fees).

- If the investment option does not have a fixed return, the expense ratio or other description of the option’s annual operating expenses and descriptions of any ongoing operating expenses (e.g., wrap fees, mortality, and expense fees).

- For any designated investment alternative, the total annual operating expenses shall be expressed as a percentage and calculated in accordance with the participant fee disclosure requirements. Any other information that is required to meet the participant fee disclosure requirements also must be provided as long as it is reasonably available to the service provider. This additional information may include:
– Identifying information about the alternative, including, for example, the issuer and the investment objective;
– Performance data, including, for example, portfolio turnover rate;
– Benchmarks;
– Principal strategies and principal risks; and
– Other fee and expense information specific to the particular alternative.

The plan asset fiduciary need not furnish this disclosure if the plan recordkeeper or broker has provided all of the required information. The recordkeeper or broker may be able to meet its disclosure obligation by providing current disclosure materials of the investment fund issuer (e.g., a prospectus) or information replicated from such materials. The recordkeeper or broker will be relieved from liability for any errors in such material if the issuer is not an affiliate, the issuer is a registered investment company, an insurance company, a publicly traded security issuer or a financial institution supervised by a state or federal entity, and the recordkeeper or broker does not know that the information is incomplete or erroneous. The provider also must furnish a statement to the plan fiduciary that it does not vouch for the accuracy or completeness of such issuer’s materials. These specific investment disclosure requirements do not apply to investments made available through a plan’s self-directed brokerage window (but the other general requirements do apply).

Sample Guide to Initial Disclosures

There is no particular arrangement or format required to be used by a service provider to make the required disclosures. However, it appears that the final rule will not be the final word on this issue. The DOL notes that it expects to engage in another round of rule-making that might result in a directive regarding the format of disclosures. During the interim, the DOL has included a sample guide in the regulations that may be used by a service provider. The sample guide is a means to organize the information that is located in different documents and from different sources. It should be helpful to many service providers and plans where disclosure is provided through multiple sources.

Timing of Initial Disclosure Requirements

Generally, disclosures must be provided reasonably in advance of entering into (or extending or renewing) a contract or arrangement for services. After the initial disclosure:

- If a provider becomes a fiduciary of plan assets, the provider must deliver the necessary disclosures as soon as practicable but not later than 30 days of knowledge that it is a plan asset fiduciary.
- If any of the initial disclosure information changes, then the covered service provider generally must report the changes as soon as practicable, but no later than 60 days from the date the covered provider is informed of the changes. However, if the 60-day requirement is not possible due to extraordinary circumstances beyond the control of the provider, then disclosure must be made as soon as practicable.
- There is an exception to the 60-day rule for changes to the investment-related information. The DOL was persuaded that the continual flow of updated information resulting from changes to investment-related information would not give plan fiduciaries useful and meaningful disclosure. Consequently, the rule now requires that updates to the investment-related information be provided at least annually.
Disclosure Upon Request of Responsible Plan Fiduciary or Plan Administrator

A covered service provider must convey any information relating to the compensation that is required to comply with a plan’s reporting and disclosure obligations (e.g., Schedule C to the Form 5500) upon the written request of the responsible plan fiduciary or the plan administrator. Such information must be provided by the service provider reasonably in advance of the date upon which the plan administrator/fiduciary has stated that it must comply with the applicable requirement, unless it is not possible due to extraordinary circumstances beyond the control of the provider, in which case disclosure must be made as soon as practicable.

Disclosure of Errors

If a service provider acts in good faith and with reasonable diligence, a contract or arrangement will not be unreasonable just because a covered service provider makes a disclosure error. The covered service provider must correct the error as soon as practicable but not later than 30 days of the date the provider has knowledge of an error or omission.

Plan Fiduciary Prohibited Transaction Exemption

The regulations incorporate a prohibited transaction class exemption for plan fiduciaries. A plan fiduciary receiving the disclosures will not be in violation of the prohibited transaction rules in the Code and ERISA if the provider was unaware of the disclosure failure of a covered service provider and reasonably believed that the provider was in compliance with the disclosure rules. Once the plan fiduciary discovers a disclosure defect, it must make a written request of the applicable covered service provider requesting the necessary disclosures. The plan fiduciary must report the disclosure violation to the DOL if the provider does not comply with the request within 90 days of the disclosure request. The notice to the DOL must include specific information, including whether the service provider continues to provide services to the plan. The deadline for filing the notice is 30 days following the earlier of the date of a service provider’s refusal to comply or the expiration of the 90-day period after the written request. The fiduciary also must consider how long to retain the services of a noncompliant service provider. The final rules indicate that the plan fiduciary will terminate the relationship with a noncompliant service provider as expeditiously as possible, in accordance with general standards of prudence.

Preemption of State Law

The final regulations do not preempt or supersede any state law governing disclosure of information by parties unless the law would prevent the application of the service provider fee disclosure requirements. (Whether the general ERISA rules regarding preemption would supersede certain state law fee disclosure requirements is a separate question.)

Application of Section 4975 of the Internal Revenue Code

A violation of the disclosure requirements in the final regulations also will constitute a violation by a covered service provider of the parallel prohibited transaction provisions in Section 4975(d)(2) of the Code. The DOL has the authority to interpret the statutory provisions that define prohibited transactions.
Termination of Contract or Arrangement

The DOL did not make any changes to the original provision of the 408(b)(2) rules that require service arrangements to permit the fiduciary to terminate the arrangement on “reasonably short notice” if the arrangement has become “disadvantageous” to the plan. No penalty may be imposed for early termination. Note, however, that a provision in a contract that allows reasonable compensation to the service provider for actual losses upon early termination of the contract is not a penalty. For example, a fee that allows the recovery of startup costs is not a penalty. Additionally, a provision in a lease for a termination that allows for reasonably foreseeable expenses related to the vacancy or reletting is not a penalty.

The new rules do require specific disclosure of compensation related to the termination of a contract. Accordingly, where a contract contains a provision for specific fees upon early termination, such fees now have to be included in service provider disclosures.

Effective Date

The final regulations are effective on July 1, 2012. The regulations will apply to all existing contracts, as well as contracts extended or entered into on or after the effective date.

Important Definitions

**Affiliate** generally means a person or entity that controls, is controlled by, or is under common control with the covered service provider, or an officer, director, or employee of or partner in the covered service provider.

**Compensation** means anything of value, including nonmonetary compensation of more than $250 over the life of the contract or arrangement. Compensation may be expressed in dollars, a formula, percentage, a per capita charge or other reasonable methods if stated methods are not sufficient. The compensation description may include a reasonable and good faith estimate if compensation cannot otherwise be reasonably described. If an estimate is used, the methodology and assumptions for such an estimate must be disclosed. Enough information must be provided to allow the plan fiduciary to determine whether the estimate is reasonable.

A **designated investment alternative** is defined as an investment option designated by the covered plan into which participants may direct the investment of their assets in an individual account plan. A designated investment alternative does not include a brokerage window account or other similar investment outside of a plan’s core investment options.

**Direct compensation** is compensation received from or reimbursed by the covered plan.

**Indirect compensation** is compensation received from parties other than the plan, the plan sponsor, the covered service provider or its affiliates. Compensation received from a subcontractor is indirect compensation, unless it is received in connection with the subcontractor’s services under the service provider’s contract.
Recordkeeping services include plan administration and monitoring of plan transactions (e.g., enrollment, payroll deductions, and contributions; offering of designated investment alternatives and other covered plan investments; loans; withdrawals; and distributions), and the maintenance of participant and beneficiary accounts, records, and statements.

The responsible plan fiduciary is the fiduciary with the authority to decide whether to enter into or extend or renew a contract or agreement with a service provider.

A subcontractor is a nonaffiliated person or entity under contract with the covered service provider or its affiliates that expects to receive at least $1,000 in compensation for one or more of the services described by the covered service provider as covered by the contract or arrangement for services.

Resources

The full text of the final regulations is available at: http://www.gpo.gov/fdsys/pkg/FR-2012-02-03/pdf/2012-2262.pdf

The EBSA fact sheet is available at: http://www.dol.gov/ebsa/newsroom/fs408b2finalreg.html

Information about changes to the final service provider regulations is available at: http://www.dol.gov/ebsa/408b2changes.html

The EBSA news release is available at: http://www.dol.gov/ebsa/newsroom/2012/11-1653-NAT.html

Conclusion

In summary, Aon Hewitt has always been a vocal proponent of uniform and transparent fee disclosure that enables plan fiduciaries to understand the compensation (and other revenue) received by service providers. Plan fiduciaries and participants will benefit from the evaluation of the reasonableness of compensation, as well as the uniform comparison of compensation and services offered under different service models. The final rules represent a significant step toward greater disclosure. The impact of the new regulations will become apparent as service providers commence compliance efforts and plan fiduciaries evaluate the information they receive.

If you would like assistance in evaluating how best to implement your obligations under these new regulations, please contact your Aon Hewitt consultant.
About Aon Hewitt

Aon Hewitt is the global leader in human resource consulting and outsourcing solutions. The company partners with organizations to solve their most complex benefits, talent and related financial challenges, and improve business performance. Aon Hewitt designs, implements, communicates and administers a wide range of human capital, retirement, investment management, health care, compensation and talent management strategies. With more than 29,000 professionals in 90 countries, Aon Hewitt makes the world a better place to work for clients and their employees. For more information on Aon Hewitt, please visit www.aonhewitt.com.

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