

# PUBLICATION

---

## New ERISA Disclosure Requirements

**Authors: William E. Robinson**

**July 26, 2012**

According to a recent survey conducted by the AARP, 71 percent of 401(k) plan participants think they pay no fees relating to their retirement accounts. In many cases, this misconception is due to opaque fee arrangements that make it difficult to determine exactly how much was being paid by the retirement plan, by whom and to whom. Even if the responsible plan fiduciaries were aware of the plan level costs, existing fee arrangements make it difficult for each participant to determine what portion of those costs were being charged to or deducted from their account in one way or another.

Two new impending sets of federal disclosure rules should help plan fiduciaries and participants better understand plan costs. The first set of rules require that plan fiduciaries be better informed by service providers about the details of fees and costs associated with their service arrangements. A second set of rules will require the plan fiduciaries to disclose information to plan participants regarding overall plan costs, as well as each participant's individual share of the costs associated with their retirement account.

### Disclosures by Service Providers to Plan Fiduciaries

Retirement plans that are subject to the Employee Retirement Income Security Act of 1974, as amended (ERISA), are generally prohibited under ERISA Section 408 from contracting for plan services unless the contract is for necessary services at a reasonable cost. Contracts for unnecessary services or for services at more than reasonable compensation would be a "prohibited transaction," exposing the parties involved to penalties and personal liability for resulting plan losses. It is the responsibility of the plan fiduciaries to determine that both of these requirements are satisfied. Although a determination that a service is necessary would normally be fairly straightforward, a determination that the cost is reasonable is impossible without adequate information and can be a difficult proposition even with detailed information. In addition, without good information about the sources of payment and how those payments are being shared, the plan fiduciaries may not be able to assess possible biases or conflicts of interest which may be present in the service arrangement.

The Department of Labor (DOL) issued final regulations on February 2, 2012 under ERISA Section 408(b)(2), describing the cost disclosures required to avoid "unreasonable" or "prohibited" service arrangements. The new regulations generally apply to any plan that is subject to ERISA, with limited exceptions.

Covered Service Providers. Only a service provider that contracts directly with the covered plan, termed a "covered service provider" (CSP), will have an obligation to disclose information to a "responsible plan fiduciary" (the plan fiduciary with the authority to contract for services). CSPs include any party providing fiduciary services (including fiduciary services to an investment vehicle in which a plan directly invests), registered investment adviser services, recordkeeping or securities/brokerage services for an account balance plan which allows participant-directed investments, or accounting, actuarial, appraisal, banking, custodial, investment policy, monitoring, insurance, investment advisory, recordkeeping, brokerage, administration or valuation services when the service provider, or its affiliate or subcontractor, reasonably expects to receive any indirect compensation. If the services will be provided as a fiduciary or registered investment adviser, the agreement must state so. Only arrangements where more than \$1,000 in compensation is reasonably

expected to be received by the CSP, and/or by an affiliate or subcontractor of the CSP over the term of the contract, are covered.

Timing of Disclosures to Responsible Plan Fiduciaries. The initial disclosure of compensation from the CSP to the responsible plan fiduciary must generally be made before the effective date of a plan service contract, as well as before any renewal or extension of an existing contract. Disclosure regarding investment options in participant-directed investment arrangements is required before the investment is added as an option. Ongoing disclosures of changes to investment-related information are required to be made as soon as is practicable in some cases, and annually in other cases. When information is requested from the CSP by a plan fiduciary or plan administrator to comply with a plan's reporting or disclosure obligations, that information must normally be provided reasonably in advance of the stated compliance date for the reporting or disclosure obligation. Errors or omissions in data must be corrected promptly, and in any event within 30 days of when the error or omission is known to exist.

Information that Must be Disclosed by CSPs. In general, CSPs must describe to the plan fiduciary the services to be provided and all direct and indirect compensation to be received by a CSP, its affiliates, and any subcontractors. The specific disclosures that will be required vary somewhat from one type of service provider to the next, according to the nature of the services, whether the CSP receives direct or indirect compensation and the details of any compensation sharing.

In the case of fiduciaries to funds in which a plan invests directly, or record keepers who make investment options available to participants, information regarding the costs associated with the investments must be disclosed, such as sales loads and other costs or fees. If services will be reduced by other compensation which may be received by the service provider, a good faith estimate of the eventual cost to the plan is required.

A written description of the services to be provided is required, in enough detail to allow that fiduciary to make an informed decision about the necessity of the services and the overall compensation to be received for those services.

If a CSP or its affiliate or subcontractor receives any indirect compensation, concerns arise about possible bias or conflicts of interest because of other interests which give rise to that other compensation. Thus, for indirect compensation, disclosure of the arrangement between the CSP (or subcontractor or affiliate) and the source of the indirect compensation is required. Indirect compensation includes anything of value that is even remotely related to the plan service arrangement, whether or not it is for services provided to the plan.

The manner of receipt of compensation must be disclosed. For example, the compensation might be billed or deducted from plan accounts or investments. Where compensation will be shared among the CSP and any subcontractor or affiliate, compensation which is transaction based or charged against the asset values must be described, along with identifying the payers and recipients of the compensation and a description of their relationship. Compensation due on termination of the service arrangement must be described, with a description of how any prepaid amounts will be calculated and refunded.

Providing Estimates and Summaries to Plan Fiduciaries. A CSP may provide estimates of fees where the fees themselves are not ascertainable at the time the disclosure is required, provided the method and assumptions used to prepare the estimate are also explained. Although the DOL does not require a summary or guide to assist fiduciaries who receive the required information, the DOL encourages CSPs to provide a summary and, in fact, included a format for such a summary as an appendix to the final regulation. The DOL is considering whether to require a summary beginning at some later date.

## **Disclosures by Plan Fiduciaries to Plan Participants**

The rules discussed above address information that CSPs are required to disclose to responsible plan fiduciaries. The second set of rules, under ERISA Section 404(a)(5), relates to disclosures by plan fiduciaries to plan participants in ERISA-covered account balance plans which allow participant-directed investments. IRAs, individual retirement annuities, SEP plans or simple retirement accounts are not covered by the rules.

Timing of Disclosures to Plan Participants. General information must be provided to participants and beneficiaries by the date upon which they can first direct investments, and at least annually thereafter. For calendar year plans, the initial *annual* disclosure must be furnished to participants no later than August 30, 2012, which is 60 days after the July 1 effective date for disclosures by the CSPs to the plans. The annual statements will provide the latest available general operational, identification and expense information. The general and operational information will include investment election procedures, limitations on elections and investments into or out of available investments, voting rights and information about general plan administration expenses which may be charged to participant accounts in addition to expenses inherent in the investment funds. For administration expenses, there must be an explanation of how those costs will be allocated to individual accounts. Identification data will include the investment alternatives which are offered, information on any investment managers, and information about "brokerage windows" and self-directed brokerage or similar accounts.

Changes in the required annual information generally must be disclosed at least 30 and not more than 90 days before the effective date of the change, unless due to unforeseeable or circumstances beyond the control of the plan administrator, in which case the revised information must be provided as soon as is reasonably practicable.

The first *quarterly* statement to participants at an account level, indicating how much of those costs are actually being periodically allocated to each participant's account, must be furnished no later than November 14, 2012.

Other Prospective Disclosures that Must be Made to Plan Participants. By the date a participant is permitted to direct investments, there must be provided an explanation of any personalized fees or expenses that may be charged prospectively against the participant's account on an individual basis, such as for processing loans, distributions, domestic relations orders, etc.

Information must be provided regarding the available investments, including the name and type of the investment, performance data, benchmark data, and fee and expense information. Where an annuity purchase option is included in an investment, additional information about that option may be required. Investment information should be provided in a comparative format to ease understanding, with contact information for requesting further information or hard copies of data.

Once an investment is elected, additional information must be provided to the participant, such as information about voting rights. Upon request, copies of any prospectus, financial statements or reports, valuations and portfolio assets must be provided.

Plan administrators may act reasonably and in good faith in relying on information provided by service providers and the issuers of investment alternatives.

## **What You Should Know**

The new fee disclosure requirements will require more detailed and more readily understandable cost information for participants. This should result in heightened participant awareness of plan costs, which of

course is the purpose of the new rules. Better information from the CSPs is critical to this improved participant understanding. However, once participants understand that they are actually paying costs associated with their retirement accounts, or in some cases once participants have a better understanding of the levels of cost charged to their account and the reasons for those costs, plan administrators and fiduciaries should be aware they will be the recipients of more questions and complaints. Some participants may ask for older historical information and may take the position that their plan's fiduciaries should have done more, and earlier, to lower the plan's costs. Some plans have already instituted better communications to help participants understand both the needs for services and their inherent costs and that "cheapest is not always best."