

# **408(b)(2) Interim Final Regulations Participant Disclosure Final Regulations**

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# Today's Topics

- Retirement Plan Fees and Disclosures
  - Overview
  - Excessive Fee Litigation
- 408(b)(2) Interim Final Regulations
- Participant Disclosure Final Regulations

# Overview

- Retirement plan fees and fee disclosure have been of significant interest to Congress, regulatory agencies and potential litigants alike in recent years
- Beginning late 2006, several class action lawsuits were filed claiming breaches of fiduciary duty under ERISA for, among other things --
  - paying excessive fees, and
  - failure to fully disclose fees charged to 401(k) plans and participants

# Overview (continued)

- Bills were introduced in Congress to address DC plan fee disclosure and conflict of interest issues
- At the same time, DOL was working on a number of regulatory projects aimed at enhancing service provider fee disclosure for ERISA plans
- The DOL initiative consists of three parts --
  - Modifications to Schedule C to the Form 5500
  - Interim final regulations under section 408(b)(2) of ERISA
  - Participant disclosure final regulations

# Excessive Fee Litigation

- Over the past four years, many 401(k) plan sponsors and their services providers have been defendants in lawsuits alleging that the plans were paying excessive fees for services
- Brought by or on behalf of plan participants --
  - *Hecker v. Deere* (7th Cir. 2009)
  - *Braden v. Wal-Mart* (8th Cir. Nov. 25, 2009)
  - *Tibble v. Edison International Inc.* – Filed in the United States District Court for the Central District of California on August 16, 2007, as a class action

# Excessive Fee Litigation (continued)

- Brought solely against service providers --
  - *Haddock v. Nationwide Fin'l Services Inc.* (D. Conn. 2006)
  - *Zang v. Paychex Inc.* (W.D.N.Y. Aug. 2, 2010)
  - *Leimkuehler v. American United Life Ins. Co.* (S.D. Ind. Oct. 22, 2010)
- Settlement --
  - *Kanawi v. Bechtel Corp.*, (N.D. Cal. settlement filed Oct. 12, 2010)

# 408(b)(2) Interim Final Regulations

- Certain service providers to employee benefit plans will be required to disclose detailed information to independent plan fiduciaries regarding services and the direct and indirect compensation they receive in connection with those services
- Effective July 16, 2011 –
  - Applies to all covered service contracts or arrangements as of this date
  - For preexisting contracts or arrangements, the disclosures must be furnished no later than this date

# 408(b)(2) - Covered Plans

- Unlike the proposal, the interim final disclosure requirements apply only to ERISA-governed pension plans (DB and DC), with a separate subsection reserved to deal with welfare plans in future guidance
- Does not apply to IRAs, IRA annuities, SEPs or SIMPLEs
- UPDATE: EBSA will be holding a public hearing on welfare plan issues on Dec. 7th

# 408(b)(2) - Covered Service Providers

- Only applies to certain “covered” service providers defined as a service provider that enters into a contract or arrangement with a covered plan to provide any of the following --
  - **Services as an ERISA fiduciary, including**
    - *as a fiduciary to an investment contract, product or entity that holds plan assets in which the covered plan has a direct equity investment (a plan asset fiduciary), or*
    - *as a registered investment adviser (whether under federal or state law)*

# 408(b)(2) - Covered Service Providers (continued)

- Recordkeeping or brokerage services - to a covered plan that is an individual account plan that permits participant investment direction, where “designated investment alternatives” will be made available in connection with recordkeeping or brokerage services
- Other services - such as accounting, auditing, investment advisory, recordkeeping, brokerage and consulting, for which the covered service provider, an affiliate of the service provider or a subcontractor reasonably expects to receive either --
  - *“indirect” compensation, or*
  - *“compensation received among related parties”*

# 408(b)(2) - Initial Disclosure Requirements

- A series of disclosures must be provided by the covered service provider to a “responsible plan fiduciary,” who is a plan fiduciary with the authority to cause the covered plan to enter into, or extend or renew, the contract or arrangement for the services
- The required disclosures include certain information regarding the services to be provided and a description of the expected compensation
- Additional information is required for plan asset fiduciaries, bundled service arrangements, recordkeeping services, and brokerage services that are in connection with participant-directed plans

# 408(b)(2) - Services

- Description of the services in sufficient detail to enable the fiduciary to assess the reasonableness of compensation
- If applicable, must also include a statement that the covered service provider (or its affiliate or subcontractor) will provide, or reasonably expects to provide, services either --
  - directly to the covered plan as a fiduciary,
  - as a plan asset fiduciary, and/or
  - directly to the covered plan as a registered investment adviser

# 408(b)(2) - Compensation

- Must describe the covered service provider's "direct" compensation and its "indirect" compensation
- Should include the amount the covered service provider reasonably expects to receive, either in the aggregate or by service, in connection with such services
- May be expressed as a monetary amount, formula, percentage of the covered plan's assets, or per capita charge for each participant or beneficiary
- If the compensation cannot reasonably be expressed in such terms, it may be described by any other reasonable method

# 408(b)(2) – Basic Contents

- The disclosure must –
  - contain sufficient information to permit evaluation of the reasonableness of the compensation;
  - describe the manner in which the compensation will be received; and
  - include a description of any compensation that the covered service provider reasonably expects to receive in connection with the termination of the contract or arrangement, and how any prepaid amounts will be calculated and refunded upon termination

# 408(b)(2) – Additional Information

- The plan asset fiduciary must include additional information for each affected plan asset vehicle in which the covered plan has a direct equity investment (unless covered by the special rule) consisting of descriptions of:
  - any compensation that will be charged directly against the amount invested in connection with the acquisition, sale, transfer of, or withdrawal from the plan asset vehicle;
  - the annual operating expenses if the return is not fixed; and
  - any ongoing expenses in addition to annual operating expenses

# 408(b)(2) – Bundled Services Arrangements

- Special rule for “compensation paid among related parties”
- The types of compensation that must be disclosed under this rule are those that are either --
  - Set on a transaction basis; or
  - Charged directly against the covered plan’s investment and reflected in the net value of the investment
- Otherwise, compensation paid among related parties within a bundled service arrangement need not be disclosed

# 408(b)(2) – Recordkeeping Services

- Recordkeeping fees (or their equivalent costs) must be separately disclosed without regard to whether the compensation is also covered by the other disclosure rules
- Includes services related to plan administration and monitoring of plan and participant transactions, and maintenance of covered plan and participant accounts, records and statements
- Must include:
  - a reasonable, good-faith estimate of the stand-alone cost of the recordkeeping services;
  - methodology and assumptions used to prepare the estimate; and
  - a detailed explanation of recordkeeping services to be provided

# 408(b)(2) - Designated Investment Alternative in Participant-Directed Plan

- If a covered service provider furnishes recordkeeping or brokerage services to participant-directed individual account plans, the following additional information must be provided --
  - Any compensation that will be charged directly against the amount invested in connection with the acquisition, sale, or transfer of, or withdrawal from, the designated investment alternative
  - The alternative's annual operating expenses, if the return is not fixed
  - Any ongoing expenses in addition to annual operating expenses

# 408(b)(2) - Disclosure Materials

- This disclosure requirement can be met by using the current disclosure materials of the issuer of the designated investment alternative that include the necessary information, provided that --
  - the issuer is not an affiliate of the covered service provider
  - the disclosure materials are regulated by a state or federal agency
  - the covered service provider has no knowledge of the materials being incomplete or inaccurate

# 408(b)(2) – Timing/Initial

- The initial disclosures must be provided reasonably in advance of the date the particular services contract or arrangement is entered into, extended, or renewed --
  - An exception allows 30 days to provide the disclosure when an entity that was not treated as holding plan assets becomes a plan asset entity
  - Another exception permits information relating to a designated investment alternative to be provided as soon as practicable, but not later than the date the investment alternative has been designated as such by the responsible plan fiduciary

# 408(b)(2) – Timing/Changes

- Changes to the required information must be disclosed as soon as practicable, but not later than 60 days from the date on which the covered service provider is informed of the change
- In the event disclosure is precluded due to extraordinary circumstances beyond the covered service provider's control, the information must be disclosed as soon as practicable

# 408(b)(2) – Timing/Upon Request

- Upon request, covered service provider must furnish any other information relating to the compensation received in connection with the contract or arrangement that is required for the covered plan to comply with the reporting and disclosure requirements of ERISA
- Requested information must be disclosed not later than 30 days following receipt of such a request in writing, unless precluded due to extraordinary circumstances beyond the covered service provider's control, in which case as soon as practicable

# 408(b)(2) – Service Provider Relief/Disclosure Errors

- No contract or arrangement will fail to be reasonable solely because the covered service provider, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the required information
- The provider must disclose the correct information to the responsible plan fiduciary as soon as practicable, but not later than 30 days from the date on which the provider knew of the error or omission

# 408(b)(2) – Plan Administrator Relief/Class Exemption

- The Class Exemption can protect a responsible plan fiduciary from violating the prohibited transaction rules in the event of a failure by a covered service provider to provide required disclosures
- The following conditions must be met:
  - The responsible plan fiduciary did not know that the covered service provider failed or would fail to make the required disclosures, and reasonably believed that the covered service provider disclosed the required information
  - Upon discovering the failure, the responsible plan fiduciary requests in writing that the covered service provider furnish the information
  - If the covered service provider fails to comply with the written request, the responsible plan fiduciary notifies DOL of such failure, not later than 30 days following earlier of (a) the covered service provider's refusal to furnish the requested information, or (b) 90 days after the written request is made
  - Notice must contain (among other things) a description of the services being provided, the information the covered service provider failed to disclose, and whether the covered service provider continues to provide services to the plan
- DOL's sample notice is available at <http://www.dol.gov/ebsa/DelinquentServiceProviderDisclosureNotice.doc>

# 408(b)(2) – Final Notes

- The interim final regulation provides that it is not to be construed as superseding any state law (e.g., state contract or consumer protection law) which governs service provider disclosures, except to the extent it prevents application of a requirement of the regulation
- Failure to comply can expose both service providers and plan sponsors/fiduciaries to liability for engaging in a non-exempt prohibited transaction

# Participant Disclosure - Overview

- Last month DOL released final regulations that will impose new requirements for the disclosure of fee and investment information to participants and beneficiaries in participant-directed individual account plans
- Included a final amendment to the regulations under ERISA 404(c), which provides the safe harbor from fiduciary liability for participant-directed plans

# Participant Disclosure – Overview (continued)

- Effective for plan years beginning on or after 11/1/2011 (i.e., for a calendar year plan 1/1/2012)
- Applies to all participant-directed individual account plans (e.g., 401(k))
- Does not apply to IRAs, IRA annuities, SEPs or SIMPLEs

# Participant Disclosure – Plan-Related Information

- General Operational and Identification Information relating to:
  - How to give investment instructions
  - Limitations on investment instructions
  - Exercise of voting, tender and similar rights
  - Designated investment alternatives
  - Brokerage windows, self-directed brokerage accounts or similar arrangements
  - Associated fees or expenses

# Participant Disclosure – Plan-Related Information (continued)

- Information on Administrative Expenses:
  - General explanation of fees for plan administrative services that may be charged to all participant accounts
  - Additional quarterly disclosure. including
    - *Plan-wide charges:*
      - a description of the services to which charges relate
      - explanation as to whether any of the plan’s administrative expenses for the preceding quarter were paid from the annual operating expenses of one or more of the plan’s designated investment alternatives
    - *Individual expenses charged to a participant’s account (dollar amount)*
      - e.g., for QDROs, loans or investment advice services

# Participant Disclosure – Investment-Related Information

- Identifying Information – name and category of investment, like money market, balanced, etc., along with an Internet address that will lead participants to supplemental information about the investment option

# Participant Disclosure – Investment-Related Information (continued)

- Performance Data, including:
  - For designated investment alternatives where the rate of return is not fixed (such as typical mutual funds), disclose the average annual total percentage return of the investment for 1-year, 5-year, and 10-year periods (or, if shorter, life). Stable value funds and money market mutual funds fall under this category
  - For designated investment alternatives where the rate of return is fixed (such as GICs), disclose the current rate of return and the minimum rate guaranteed under the contract, and include a statement that the issuer may adjust the rate of return prospectively

# Participant Disclosure – Investment-Related Information (continued)

- Special rules apply regarding -
  - Designated investment options that consist primarily of qualifying employer securities or that are used to purchase annuity benefits, in recognition of the different nature of such options
  - The DOL reserved a subsection to provide special disclosure rules for target-date or similar funds, which are expected to be the subject of a separate proposed regulation in the near future

# Participant Disclosure – Investment-Related Information (continued)

- Benchmark Information must be provided for other than “fixed rate” investments --
  - Name and returns of appropriate broad based securities market index over the 1, 5, 10 year periods (or life, if shorter) comparable to the performance periods provided for plan funds
  - Benchmark cannot be administered by an affiliate of the investment issuer, its investment adviser or principal underwriter, unless the index is widely recognized and used
  - Plan Administrator may blend the returns of more than one broad based index w/r/t funds that are not benchmarked or that have a blend of asset classes

# Participant Disclosure – Investment-Related Information (continued)

- Fee and Expense Information –
  - The amount and description of each shareholder-type fee
  - A description of any limitation that may be applicable to a purchase, transfer, or withdrawal of the investment in whole or in part
  - Total annual operating expenses of the investment expressed as a percentage AND as a dollar based example of the expense ratio
  - A statement that –
    - *fees are only one factor a participant should consider*
    - *the cumulative effect of fees and expenses can substantially reduce the growth of a participant's retirement account*
    - *participants can visit EBSA's website for information and an example demonstrating the long term effect of fees and expenses*

# Participant Disclosure – Website

- Plan Administrator must make sure a website is available, including
  - Name of investment issuer
  - Objectives or goals in a manner consistent with SEC Form N-1A or N-3
  - Principal strategies and principal risks in a manner consistent with SEC Form N-1A or N-3
  - Portfolio turnover rate consistent with SEC Form N-1 or N-3
  - Performance data as described above, updated at least quarterly (or more frequently if required by other applicable law)
  - Fee and expense information
  - Information on how to request and obtain free of charge a paper copy of the information required to be maintained on the website

# Participant Disclosure - Glossary

- Plan Administrator must provide a glossary of investment and financial terms, which may be included in the comparative document, on the website, or as a link to a website

# Participant Disclosure - Chart

- Plan Administrator must provide the foregoing investment-related information in a chart or similar format that facilitates comparison of the information for each investment alternative
- Chart must include:
  - **date compiled;**
  - **name and address of Plan Administrator; and**
  - **how to obtain additional information.**
- DOL has made available a model chart which can be accessed at: <http://www.dol.gov/ebsa/participantfeerulemodelchart.doc>

# Participant Disclosure - Timing

- Generally, both plan-related and investment-related information must be provided on or before the date the individual can first direct investments, and at least annually thereafter
- Information about charges must be disclosed quarterly.
- Except w/r/t actual charges, fees and expenses may be expressed as monetary amount, formula, percentage of assets or a per capita charge
- Information about any changes in disclosures must be furnished at least 30 days but not more than 90 days in advance of the effective date of the change (or as soon as reasonably practicable if circumstances do not allow for 30 days)

# Participant Disclosure - Method

- Plan-related information may be provided in SPDs or on quarterly statements
- Expense information may be included in quarterly statements
- DOL reserved the issue of use of electronic media for these disclosures

# Participant Disclosure – Final Amendment to 404(c)

- Integrates the disclosure requirements described above into the section 404(c) regulation
- Many of the requirements in the final regulations are duplicative of the existing 404(c) disclosure requirements
- Some, such as the requirement to send participants prospectuses relating to investment options, have been supplanted and are no longer applicable. (Prospectuses still must be provided on request.)
- 404(c) does not relieve a plan fiduciary of its duty to prudently select and monitor the plan's service providers and designated investment alternatives

# Contact Information

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