New Final Regulations Under ERISA Section 408(b)(2)

By Marcia S. Wagner, Esq.

Editors' Note: This month, in lieu of our regular "Document Update" column, we are featuring an extended "Legal Update." Because the new final Section 408(b)(2) regulations directly impact many of our readers' work and practices, and because of the imminence of this new regime of law, we felt it best to run Marcia Wagner's article in its entirety. "Document Update" will return next month.

On February 2, 2012, the DOL finalized its regulations under ERISA Section 408(b)(2), replacing the existing interim final regulations that require certain disclosures by plan service providers to responsible plan fiduciaries. The disclosures relate to services to be performed by service providers and the compensation they will receive, and they are required to avoid characterization as a prohibited transaction.

Effective Date. The new final rule postpones the effective date of the required disclosures from April 1, 2012 to July 1, 2012, thereby allowing additional time for compliance. The delay in the effective date would also have the additional effect of deferring initial participant-level disclosures under ERISA Section 404(a). For calendar-year plans, the initial disclosures from the plan to its participants will now be required by August 30, 2012 (rather than May 31, 2012).

Electronic Delivery. The preamble to the new final rules indicates that there is nothing in the regulation that limits the ability of service providers to furnish information via electronic media. This apparently includes making information available on a Web site if plan fiduciaries are notified as to how they can access such information. Without ready access and clear notification to fiduciaries on how to gain such access, information housed on a Web site may not be regarded as having been furnished within the meaning of the regulation. Nevertheless, it is interesting to note that the DOL's regulatory impact analysis assumes that 50% of service provider disclosures will be delivered electronically.

Summary of Disclosures. A potentially significant change in the future is the provision by service providers of a guide or disclosure summary to assist plan fiduciaries in reviewing disclosures. The DOL attached a sample guide to the final regulations as an appendix and has reserved a place in the final regulations to contain such a requirement. However, at the present time, the sample guide is only offered as a suggestion and is not required.

The sample guide included with the regulations consists of two columns. Information to be listed in the first column would include the services to be provided, various categories of service provider compensation (i.e., direct, indirect, and shared compensation), and fees and expenses relating to investment options. The second column would show where the services listed in the first column are to be found in the service agreement or where information relating to investment fees and expenses can be accessed on the Internet. Thus, such a guide is intended to enable plan fiduciaries to locate compensation information disclosed through multiple and/or complex documents.

Technical Changes. The new final rules under ERISA Section 408(b)(2) contain a number of minor technical changes and clarifications that are discussed below. Despite the changes, the new final rules are substantially similar to the interim final regulations.

Enhanced Disclosure Requirements. Service providers generally must provide plan fiduciaries with the information necessary to assess the

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reasonableness of total compensation, both direct and indirect. With regard to indirect compensation, the interim final regulations required service providers to furnish a description of all such compensation that the provider reasonably expects to receive, as well as the services for which the indirect compensation will be received and the identity of the payer of the indirect compensation. The new final regulations added a requirement that the service provider also describe the arrangement between the payer of the indirect compensation and the service provider (or an affiliate or subcontractor of the service provider) pursuant to which the indirect compensation will be paid.

In an effort to coordinate the 408(b)(2) disclosures required under the new final rule with the pending disclosures required under the participant-level disclosure rules, the new final rule harmonizes certain disclosures required for fiduciaries of "look through" investment products that are deemed to hold plan assets, such as bank collective investment trusts. The interim rule required such fiduciaries to provide descriptions of three categories of compensation-related information: (i) compensation to be charged directly against the investment in connection with events such as an acquisition, sale, transfer, or withdrawal, (ii) if the investment product's return is not fixed, annual operating expenses (e.g., the expense ratio), and (iii) ongoing expenses, such as wrap fees, and mortality and expense fees. Under the new final rule, if the investment product is a designated investment alternative ("DIA"), the latter two categories do not apply and the fiduciary must instead disclose the DIA's total annual operating expenses expressed as a percentage of the average net asset value for the year (which must also be disclosed under the participant-level disclosure rules).

The new final rule also requires fiduciaries of DIAs to disclose any other information relating to the DIA that is within the control of, or reasonably available to, the service provider. The DOL does not view this requirement as a mandate to obtain or prepare new information not under the service provider's control and has indicated that in the case of a recordkeeping platform offering mutual fund investments, the new requirement could be satisfied by passing through the prospectuses of such funds.

Disclosure by Brokers and Recordkeepers. Under the interim regulations, recordkeeping platforms were required to provide certain information with respect to the DIAs on their platforms, but were able to meet this obligation by passing through current disclosure materials of the investment's issuer, such as a prospectus. The interim rules required such disclosure materials to be regulated by a state or federal agency. The new final rule retains this concept but redirects its focus to the issuer of the investment that furnishes the pass-through materials by requiring the institution, not the materials, to be regulated.

The ability to comply with the disclosure rules by passing through materials of investment issuers is limited to issuers that are a mutual fund, insurance company, an issuer of a publicly traded security, or a financial institution supervised by a federal or state agency. In addition, the issuer may not be an affiliate of the service provider making the disclosure. The new final rule indicates that it is possible to meet the disclosure obligations by furnishing information replicated from the issuer's disclosure materials.

Timing for Disclosure Updates. Under the interim rule, changes to information furnished by service providers were required to be disclosed within 60 days of the date on which the service provider was informed of the change, unless extraordinary circumstances beyond the service provider's control made this impossible, in which case, the new information had to be disclosed "as soon as practicable." The new final regulation leaves this rule intact, but creates an exception for disclosures by both fiduciaries managing "look through" investment products as well as recordkeeping platforms. Disclosure of any changes to the investment information required for these providers must now be made at least *annually*, thereby relaxing the 60-day rule. This eliminates the need to make frequent, or even nonstop, notifications with regard to minor modifications of investment information relating to DIAs and other investment products.

Reply Deadline for Information Requests. Service providers generally must respond to the request of a plan fiduciary for any additional information needed to satisfy ERISA's reporting and disclosure requirements, such as the annual Form 5500 filing requirement. Under the interim rule, the deadline for such a response was 30 days following receipt of a written request from the fiduciary. The new final rule offers flexibility with respect to the deadline by providing that the required information merely needs to be delivered "reasonably in advance" of the reporting or disclosure deadline cited by the plan fiduciary. As under the interim rule, the new final rule provides that where the disclosure cannot be made due to circumstances beyond the service provider's control, it must be made "as soon as practicable."

Timing for Corrections. The interim rule had provided that good faith errors or omissions in disclosing information could be corrected as soon as practicable, but not later than 30 days from the date a service provider knows of the error or omission. The new final rule expands this treatment to errors or omissions that occur in connection with disclosure updates (i.e., any required disclosures describing changes to previously provided information).

"Cost" Definition. Under ERISA Section 408(b)(2), recordkeepers generally must disclose all compensation relating to their services. If a recordkeeper is serving without explicit compensation or when compensation for recordkeeping services is to be offset

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or rebated based on other compensation received by the recordkeeper, a reasonable and good faith estimate of the *cost* of the services to the plan must be provided. The new final rule now requires an explanation of the methodology and assumptions used to prepare the cost estimate. The interim rule defines "compensation" as anything of monetary value, but it did not define "cost." However, the new final rules now clarify that cost may be described or estimated in the same manner as compensation. This rule change is primarily intended to accommodate service providers that need to disclose the cost of recordkeeping services (rather than compensation).

Estimated Ranges for Compensation. With regard to whether compensation or cost may be disclosed in ranges (for example, by a range of basis points), the DOL indicated its tentative approval in the preamble to the new final rules, noting that "disclosure of expected compensation in the form of known ranges can be a 'reasonable' method for purposes of the final rule." However, the DOL indicated that, whenever possible, more specific, rather than less specific, compensation information is preferred.

Conditions for Relief Under Class Exemption. The new final rule maintains the class exemption included in the interim final regulations, which provides a plan fiduciary with relief from ERISA's prohibited transaction rules if, among other things, the fiduciary did not know that a covered service provider failed to make required disclosures and reasonably believed that such disclosures were made. Upon discovering that the service provider failed to disclose the required information, the plan fiduciary must request in writing that the service provider furnish such information.

If the service provider fails to comply with this request within 90 days, the plan fiduciary must notify the DOL. The fiduciary must also decide if the service arrangement should be terminated. Under the new final rule, this decision must now be governed by the fiduciary standard of prudence. In the DOL's view, this means that if the requested information relates to services to be performed after the 90-day period and such information is not disclosed promptly after the end of the 90-day period, the plan fiduciary must terminate the contract or arrangement "as expeditiously as possible" consistent with its duty of prudence.

Additional Exclusion from Covered Plan Definition. Service providers generally must provide the disclosures required under ERISA Section 408(b)(2) to all of their "covered plan" clients. The interim rule excluded simplified employee pensions (SEPs), SIMPLE retirement accounts, individual retirement accounts, and individual retirement annuities from the definition of a covered plan, thereby making it unnecessary for service providers to furnish disclosures to these plan clients. The new final rule further excludes certain legacy 403(b) annuity contracts from the disclosure requirement.

This relief from coverage is being provided in recognition of the fact that many 403(b) plan sponsors made certain design changes in response to plan document requirements and other recent changes in the law, voluntarily causing their plans to become subject to ERISA. However, in many instances, employers and plan fiduciaries have not had (and do not currently have) any dealings with legacy annuity contracts established by individual participants prior to the plan's voluntary ERISA conversion. For such a contract to qualify for the exclusion from the disclosure rules, it must have been issued before January 1, 2009, and the employer must not have had the obligation to contribute to the contract or have actually contributed to the contract, on or after that date. Further, the contract must be fully enforceable by the individual owner without any involvement of the employer and must be fully vested.❖

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