



ERISA ALERT

MARCH 2012

Covered Service Provider Fee Disclosures Under ERISA §408(b)(2) Required by July 1, 2012

Section 408(b)(2) of ERISA provides a statutory exemption from the legal prohibition against payment for services from a Covered Plan to any party-in-interest including a Fiduciary provided: (1) such service is necessary for the establishment or operation of the plan; (2) such service is furnished under a contract or arrangement that is reasonable; and (3) no more than reasonable compensation is paid for such service.

On February 3, 2012, the Department of Labor ("DOL") issued final regulations that establish disclosure requirements for services performed and fees charged by "Covered Service Providers" to retirement plans (the 408(b)(2) "Final Regulations"). A Covered Service Provider ("CSP") is defined to be a service provider that enters into a contract or arrangement (whether written or not) with a Covered Plan and reasonably expects to receive \$1,000 or more in compensation in connection with the services. The Final Regulations provided additional changes to the "interim final" regulations published on July 16, 2010.

The deadline for compliance under the Final Regulations is July 1, 2012 (previously April 1, 2012). The effective date for compliance under ERISA §404(a) Participant Fee Disclosure Regulations was extended to August 30, 2012 so that Plan Fiduciaries may incorporate information disclosed under the Final Regulations.

On or before the effective date, the CSPs must provide or disclose:

- A description of the services provided to the Covered Plan.
- The status of the CSP as a fiduciary to the Covered Plan.
- An estimate of direct and indirect compensation received or paid to other CSPs.
- An estimate of the cost of record keeping services (if record keeping is provided).
- Manner of receipt/payment of compensation (billing versus deduction from plan assets).
- An estimate of investment fees and expenses (if designated investments are provided).

These disclosures will enable Plan Fiduciaries to assess the reasonableness of

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compensation paid for the services and to identify any conflicts of interest.

If a CSP fails to deliver the information accurately or in a timely manner, the Final Regulations now provide a mechanism for Plan Fiduciaries to report the deficiency and shift the compliance burden to the CSP through the filing of a **Delinquent Service Provider Disclosure ("DSPD") Notice** to the DOL and IRS. A DSPD Notice filing exposes the CSP to possible excise taxes and disgorgement of previously earned compensation.

Further, if a CSP does not provide information within 90 days of a written request, the Plan Fiduciary must determine whether or not to terminate the contract or arrangement. In deciding, the Plan Fiduciary must act consistently with the duty of prudence under ERISA §404, considering factors such as the nature of the failure and the availability and costs of a replacement CSP. However, if the requested information relates to future services (service performed after the end of the 90 days following the written request), the Plan Fiduciary shall be obliged to terminate the contract or arrangement as quickly as possible.

The Final Regulations apply to any CSP that reasonably expects to receive \$1,000 or more in **"direct"** or **"indirect compensation"** and who provides the following services:

- Services directly to a Covered Plan as a Plan Fiduciary under ERISA or the Investment Advisers Act of 1940.
- Services as a Plan Fiduciary for investment vehicles that hold plan assets.
- Services as a Registered Investment Advisor ("RIA").
- Recordkeeping or brokerage services to participant-directed plans that offer one or more "designated investment alternatives" under ERISA §404(c).
- Other services, such as accounting, actuarial, legal and other professional services, consulting, banking, insurance, securities or other investment brokerage, recordkeeping and third party administration services, among others, if the CSP receives indirect compensation (including compensation paid by anyone other than the plan sponsor, the plan itself or any affiliate of the service provider).

As used in the Final Regulations, "direct compensation" includes anything of monetary value (other than non-monetary compensation valued \$250 or less) that the CSP's firm, affiliate or subcontractor expects to receive from the plan. **Direct compensation, however, does not include payments from the Plan Sponsor that are not from plan assets.** If applicable, the CSP must disclose the following: (i) the manner in which direct compensation is determined (e.g., as an amount, formula, per capita charge or percentage of plan assets); and (ii) the manner of receipt (i.e., whether the compensation will be billed to the plan or deducted directly from participant accounts).



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"Indirect compensation" is defined to be any compensation received for the provided services from any source other than the Covered Plan or the Plan Sponsor. If applicable the CSP must provide the required disclosures by: (i) identifying the services for which the indirect compensation is received; (ii) the payer(s) of indirect compensation; (iii) describing how the indirect compensation is determined (e.g., as an amount, formula, per capita charge or percentage of plan assets); and (iv) the manner of receipt (i.e., whether the compensation will be billed directly or deducted from the Covered Plan's account or investments).

The Final Regulations further provide:

- "Direct compensation" includes (i) compensation initially paid by the Plan Sponsor, but which is then subsequently reimbursed from the plan, and (ii) compensation paid directly from participants' and beneficiaries' accounts.
- When disclosing "Indirect compensation," the CSP must (a) identify the covered services, (b) identify the payer, and (c) describe the arrangement between the payer and the CSP, affiliate, or subcontractor, as applicable. For purposes of service arrangements involving securities purchased through brokerage windows, self-directed brokerage accounts, or similar arrangements, the descriptions of indirect compensation may be expressed in general terms, but must be sufficient for a Plan Fiduciary to evaluate the reasonableness of the compensation in advance of the arrangement.
- The definition of compensation includes "cost" as an element. A description of compensation or cost may be expressed as a monetary amount, formula, percentage of the assets, or a per capita charge for each participant or beneficiary. If the compensation or cost cannot be reasonably expressed in such terms, the CSP is permitted to use any other reasonable method, including a good faith estimate, provided that the CSP explains the methodology and assumptions used for the estimate.

CSPs must include an acknowledgment of whether rendering of services are reasonably expected to give rise to fiduciary status under ERISA and/or the Advisers Act. Section 3(21) of ERISA defines a "fiduciary" as anyone who:

- exercise discretionary authority or control in the administration of the plan;
- exercises discretionary authority or control with respect to the management or disposition of plan assets; or
- renders investment advice to a plan for a fee or other compensation, direct or indirect.

Because this is a functional definition that focuses on the activities of the CSP, its title or position is immaterial.

The Final Regulations also clarify who must provide disclosures in an



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arrangement where the CSP outsources some of the services and pays compensation to such other provider(s):

- Although affiliates or subcontractors of the CSP may (a) provide some or all of the services under the contract or arrangement or (b) receive some or all of the compensation for the services, the affiliates or subcontractors do not, themselves, become "covered service providers" solely as a result of the services they perform.
- In an arrangement where multiple services are provided to a Covered Plan, only the CSP (the party entering into the arrangement with the Covered Plan) is responsible for making the 408(b)(2) disclosures.

In the future, CSPs may be required to furnish Plan Fiduciaries with a summary or guide, separate from the initial disclosures, identifying certain information such as the document, section and page number where descriptions of services and compensation may be found. The Final Regulations contain an appendix as a sample guide. Presently, the use of the sample guide is strictly voluntary at this point in time. However, the DOL has indicated that it will issue proposed regulations on this issue in the near future, and the sample guide, or something similar, may be required in the future.

The deadline for disclosure of changes to initial information previously disclosed that are investment-related must be made at least annually.

The Final Regulations address the time by which a CSP must provide requested information to a Plan Fiduciary to enable such person to comply with any reporting and disclosure requirement (e.g. Form 5500 and any related schedules).

Upon receipt of a written request from a Plan Fiduciary, the CSP must provide such information reasonably in advance of the deadline for any reporting and disclosure requirements, unless the disclosure is impossible due to extraordinary circumstances beyond the CSP's control (in which case the information must be disclosed as soon as practicable).

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