D-Days: DOL Closes Circle On Disclosure

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On February 2, 2012, the U.S. Department of Labor (DOL) published final service provider disclosure regulations. The deadlines for the disclosure requirements are now July 1, 2012, for service provider disclosures and August 30, 2012, for most plans for participant disclosures. This is only a 90-day extension of the previous deadlines of April 1, 2012, and May 31, 2012. The final service provider regulations contain substantive changes from the interim rules, including welcome coordination of investment-related disclosures with those required by the participant disclosure regulations.

The final service provider disclosure regulations can be found here.

A summary of the final participant disclosure regulations can be reviewed here.

The new deadline dates will not change. Disclosure deadlines loom for all plan sponsors. Responsible plan fiduciaries must take steps to prepare for the July 1 effective date. It is not necessary for existing service provider contracts to be amended by July 1, but many plan sponsors will want to add a provision committing the service provider to compliance with the disclosure requirements. Without the required disclosure, any existing contract will be a prohibited arrangement.

Purpose

But for a statutory exemption, the furnishing of goods and services between a plan and a party in interest is a prohibited transaction under ERISA. However, Section 408(b)(2) provides a statutory exemption if the contract is reasonable, the services are necessary, and no more than reasonable compensation is paid. Previously the regulations defined a “reasonable contract” as one that can be terminated on short notice without penalty. The new service provider disclosure regulations retain this requirement but mandate that a service contract or arrangement is not reasonable unless the service provider discloses specified information to a responsible plan fiduciary.

Responsibility

Although the basic responsibility upon covered service providers, the plan fiduciary must supervise and monitor the disclosure and must act in the event of failure. The requirements apply to any pension plan (both DB and DC) covered by ERISA but exclude governmental and church plans, severance plans, simplified employee pensions (SEPs), simple retirement accounts (SIMPLEs), individual retirement accounts and individual retirement annuities. The final regulations also exclude frozen annuity contracts or custodial accounts under 403(b) plans. Guidance for welfare plans is in process. The disclosure requirements apply to “covered service providers” that reasonably expect to receive $1,000 or more in compensation for providing services. The responsibility cannot be avoided by the use of affiliates or subcontractors. Covered service providers are:

- Those providing ERISA fiduciary services directly to the plan, those providing services to the plan as an investment adviser registered under the Investment Advisers Act of 1940 or any state law, and those providing ERISA fiduciary services to an investment that holds plan assets and in which the covered plan has a direct equity investment.

- Those providing recordkeeping or brokerage services to an individual account plan permitting participants and beneficiaries to direct the investment of their accounts, if one or more designated investment alternatives will be made available through a platform or similar mechanism in connection with those services.

- Those who receive indirect compensation, as defined, for services in the following categories: accounting, auditing, actuarial, appraisal, banking, consulting related to development or implementation of investment policies or objectives or to the selection or monitoring of service providers or plan investments, custodial, insurance, investment advisory (for plan or participants), legal, recordkeeping, securities or other investment brokerage, third party administration, or valuation services provided to the plan.

In the case of bundled arrangements the service provider entering into the contract with the plan is the covered service provider unless the service providers agree otherwise.

A service provider that contracts with and is paid by the plan sponsor is not subject to the disclosure requirements.

What Must Be Disclosed Initially

The following information must be disclosed in writing reasonably in advance of entering into, extending or renewing a contract for services:

- A clear and understandable description of all services to be provided by the service provider including services beyond those that makes it a covered service provider.

- A statement of the provider's (and any affiliate's or subcontractor's) fiduciary status and/or services as a registered investment adviser.

- Comprehensive information about all direct and indirect compensation that will be received. Direct compensation is compensation received directly from the plan (excluding non-monetary amounts of $250 or less), including any amounts paid by the sponsor but reimbursed from the plan. Indirect compensation is compensation received from any source other than the plan, the plan sponsor, the covered service provider or an affiliate. This includes such things as sales loads or charges, deferred sales charges, redemption fees, surrender or exchange fees, account fees, operating expenses, wrap fees, mortality fees and other revenue sharing fees and expenses. The services that generate indirect compensation and the payer of indirect compensation must be identified and the relationship or arrangement between the payer and the covered service provider must be described. The intent is to identify potential conflicts of interest related to indirect compensation.

- A description of compensation paid among a service provider, affiliate or subcontractor if paid on a transaction basis (such as commissions, soft dollars, finder's fees or similar incentive based on amount involved) or charged directly against an investment and reflected in the net value of the investment (e.g., 12b-1 fees). This disclosure must identify the services and the payers and recipients and is required even if it duplicates other compensation disclosures.

- A description of compensation reasonably expected in connection with the termination of the contract or arrangement and how pre-paid amounts will be refunded on termination.

- The disclosure must also separately include all direct and indirect compensation in connection with recordkeeping services, or if not specified or if subject to offset, a reasonable, good faith estimate of the costs of the recordkeeping services and an explanation of the basis for the estimate.

Additional disclosure is required from providers of fiduciary services to an investment arrangement that holds plan assets. It is rare for plan assets to be held outside of a plan, but if so these requirements are extensive.

Similar extensive investment disclosures are required from providers of recordkeeping and brokerage services to participant directed plans if one or more designated investment alternatives are made available in connection with those services. Subject to certain conditions, this requirement may be satisfied by passing through disclosure materials from the issuer of the designated investment alternative or providing information based on those materials.

The final rule requires a description of the manner in which described compensation will be received. Examples are that the plan will be billed or the compensation will be deducted directly from the plan's accounts or investments.

Summary or Guide for Initial Disclosures

The DOL indicates that it is studying and will ultimately publish guidance on a format or guide for the required disclosures. A sample guide is attached to the final regulations and service providers are encouraged to use it in making disclosures.

Timing of Initial Disclosures

A covered service provider must disclose the required information reasonably in advance of the date the contract is entered into, extended or renewed. If an investment arrangement is subsequently determined to hold plan assets, disclosure must be made as soon as practicable but not later than 30 days from the date on which the service provider knows that plan assets are held. For new investment alternatives subsequent to the time the contract is entered into, the disclosure must be as soon as practicable but not later than the date the investment alternative is designated by the plan. For existing contracts, the deadline is July 1, 2012.

Changes to Initial Disclosures

Changes to 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. Where frequent changes occur to certain investment information, the final rule has been modified to allow disclosure of changes on an annual basis.

Reporting and Disclosure Information

In addition a covered service provider must furnish, on the written request of the responsible plan fiduciary or plan administrator, any other information relating to compensation in connection with the contract or arrangement that the plan needs in order to comply with the reporting and disclosure requirements of Title I of ERISA. The timing of this requirement changed in the final regulations to require that the information be provided reasonably in advance of the date on which the responsible plan fiduciary or administrator states that it must comply with the reporting and disclosure requirement.

Correction of Errors

The DOL recognizes there will be inadvertent errors in disclosed information. The final regulation states that an error or omission by a covered service provider acting in good faith and with reasonable diligence will not cause a service contract or arrangement to be a prohibited transaction as long as the service provider discloses the correct information as soon as practicable, but not later than 30 days, after the date on which a provider knows of the error or omission. In the final regulations it is clear that this rule applies not only to initially required disclosures but also to required changes to those initial disclosures.

Class Exemption for Responsible Fiduciary

Under a class exemption set forth in the regulations, a plan fiduciary who satisfies certain conditions may avoid engaging in a prohibited transaction when a service provider fails to disclose required information. The fiduciary must not know that the service provider failed to make required disclosures and must have reasonably believed that the disclosures were made. This is a very strict standard. Upon discovery of a disclosure failure, the fiduciary must act within specified time periods. The fiduciary must request the proper disclosure in writing, and if the service provider fails to comply with the request within 90 days, the plan fiduciary must provide a prompt and detailed notice to the DOL.
While the exemption can protect a plan fiduciary, it does not prevent the occurrence of a prohibited transaction and does not relieve the service provider from the consequences, including excise taxes.

The class exemption also requires the responsible fiduciary to determine, following discovery of the failure, whether the service contract or arrangement can prudently be continued. In making this decision a plan fiduciary must balance factors such as the nature of the failure and the availability and cost of replacing the service provider, but the DOL notes that it does not intend continuation of service contracts or arrangements indefinitely if there is an unresolved disclosure failure. The DOL emphasizes that a fiduciary's determination is governed by the prudence requirements of ERISA and that if the requested information is not disclosed promptly after the 90-day period following the written request, then the plan fiduciary will terminate the arrangement as expeditiously as possible consistent with the duty of prudence. This is a stronger statement of the duty to terminate on the basis of a disclosure failure than was included in the interim regulations.

D-Days Are Coming!

What have been dubbed in the title to this article as Discovery Days or D-Days are now set in stone. The final regulations make clear that existing contracts and arrangements must be in compliance with the service provider disclosure rules on July 1, 2012, and that participant-directed individual account plans with plan years beginning on or after November 1, 2011, must be in compliance with the participant disclosure rules by August 30, 2012, or, if later, 60 days after the first day of the next plan year (later dates apply only to plan years beginning in August, September, or October). The deadline for the first quarterly disclosures under the participant fee disclosure rules is November 14, 2012, or, if later, 45 days after the end of the quarter in which the first annual disclosure is made.

What must a plan sponsor do? Hopefully some of the following steps are already in process:

- Inventory and obtain commitments from investment and other covered service providers to provide the required information.
- Establish a process for evaluating the information disclosed by your service providers.
- Determine the presentation format and prepare the participant disclosures if applicable to your plan. Consider whether electronic disclosure is appropriate for you.
- Deliver disclosures by applicable deadlines. Be prepared to handle delivery failures and participant questions.

Plan sponsors cannot simply sit back and rely on service providers for necessary disclosures. Even though service providers are subject to prohibited transaction sanctions, the plan sponsor is ultimately responsible. The class exemption for responsible plan fiduciaries applies only if the responsible fiduciary does not know of a disclosure failure and believes that the required disclosures have been made. Thus, the exemption will apply only to truly innocent plan fiduciaries who subsequently discover the failure and take the necessary steps to remedy it.

Plan sponsors need help to be sure they are in compliance with the service provider disclosure requirements and to prepare for timely compliance with the participant fee disclosure requirements. The Employee Benefits Practice Group at Warner Norcross & Judd is ready to provide the advice and help that you need.

Compliance with the new service provider and participant disclosure requirements is not something that we can simply prepare and send to you as we can with required plan amendments. However, we can provide assistance and direction in making the contacts and gathering the necessary information and will work with you to prepare an appropriate presentation of that information and deliver it on a timely basis. Although the July 1 and August 30, 2012 deadlines may still seem distant, it is important that you begin preparation now.

Please contact George L. Whitfield (616.752.2102 or gwhitfield@wnj.com) or any other member of our Employee Benefits Practice Group.