PART XIII: DISCLOSURE REQUIREMENTS

Disclosure Regulations for Retirement Plan Service Providers

3990. What are the fee disclosure requirements imposed by the Department of Labor (“DOL”)?

In recent years the DOL has taken a three pronged approach in educating plan sponsors and participants about fees related to qualified retirement plans.

The first prong of the DOL’s approach to fee education requires all large plan filers to complete a Schedule C with their annual 5500 series report. Schedule C reports compensation exceeding $5,000 that has been paid to plan service providers in the reporting year. The compensation reported must be categorized as either direct or indirect compensation. Payments received directly from the covered plan are direct compensation. Compensation received from sources other than directly from the plan or plan sponsor is indirect compensation.

The second prong of the DOL’s disclosure initiatives are promulgated under ERISA Section 408(b)(2). The regulation requires covered service providers to disclose compensation in excess of $1,000 to responsible plan fiduciaries. The initial disclosures were due by July 1, 2012. Providing these disclosures is the responsibility of the covered service provider; however, if the covered service provider does not provide the disclosures, the responsible plan fiduciary must request them or risk having the contract between the service provider and plan deemed a “prohibited transaction.”

The third and final prong of the DOL’s fee disclosure initiative requires disclosure to plan participants in individually directed account plans. For calendar year plans, the deadline for initial participant fee disclosures was August 30, 2012. Following the initial disclosures, plans are required to make ongoing disclosures to participants and beneficiaries in participant-directed individual account plans on an annual basis, with quarterly disclosures identifying fees and expenses deducted from the participant’s account in the prior quarter.

A checklist for service providers and responsible fiduciaries to use as guidance for compliance with these new requirements is available online at www.TaxFactsUpdates.com.

3991. What is the purpose of the Department of Labor (“DOL”) 408(b)(2) covered service provider disclosure regulations?

Given the changes in the retirement industry in recent years, the DOL believes that the fee and cost structures associated with retirement plans have clarity to the often confusing world of fees and expenses associated with retirement plans, the DOL has promulgated disclosure regulations intended to help shine a light on the costs of operating a retirement plan.

When selecting and monitoring service providers, ERISA requires plan fiduciaries to act prudently and solely in the interest of the plan’s participants and beneficiaries. Responsible plan

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fiduciaries must ensure that arrangements with service providers are "reasonable" and that only "reasonable compensation" is paid for services. Unfortunately, there is no bright line rule defining what is "reasonable compensation." In the 408(b)(2) regulations, the DOL delineates that "No contract or arrangement for services between a covered plan and a covered service provider, nor any extension or renewal, is reasonable" unless appropriate fee disclosures are made.

Thus, for any contract or arrangement between a covered service provider and an ERISA retirement plan to be considered "reasonable," the covered service provider must make certain disclosures to the responsible plan fiduciary. Even if the service provided and the compensation received is fair and in line with industry standards, if the disclosures are not made, the agreement will be considered unreasonable. The disclosures must be sufficiently detailed to allow a responsible plan fiduciary to evaluate the prudence of the agreement and must be made reasonably in advance of entering into the contract. The responsibility for making appropriate disclosures initially falls on the service provider, however, where required disclosures are not made, the plan sponsor must request the disclosures from the service provider. If the disclosures are still not made after the disclosure request, the responsible plan fiduciary must report the covered service provider to the DOL and seek out a new service provider. If the disclosures are not made or the reporting procedure is not followed, the arrangement will constitute a prohibited transaction subject to monetary penalties reportable to the DOL, and require correction.[1]

Of course, merely making the required disclosures does not automatically make a contract or arrangement reasonable under ERISA. The compensation paid for the services provided also must also be reasonable.

The disclosures were required to be in place for all existing service arrangements by July 1, 2012. New service provider arrangements on or after that date require these disclosures reasonably in advance of the entry into the contract.

All ERISA-covered retirement plans are treated as covered plans for purposes of these regulations. The DOL has specifically exempted non-ERISA retirement plans from the requirements of this regulation. Non-ERISA retirement plans include Simplified Employer Plans ("SEPs"), salary reduction SEPs ("SAR-SEPs"), SIMPLE IRAs, government plans, non-ERISA 403(b) plans, most church plans, top hat non-qualified deferred compensation plans and 457 plans.

Other types of qualified retirement plans that cover only a proprietor and spouse, or partners of a partnership and their spouses, are exempt from ERISA as well. On the date any common law employee becomes a participant in either of these plan types, the disclosures are required.

3992. What disclosures are required under the 408(b)(2) regulations?

Required disclosures under 408(b)(2) include the following:

(1) the services to be provided,

(2) fees associated with those services,

1. Preamble to Final and Interim Reg. §2550.408b-2(c), July 16, 2010.

(3) whether the fees will be paid directly or indirectly from the plan,

(4) certain financial information on investment options,

(5) identification of any termination penalties, and

(6) an explanation of how any prepaid amounts will be handled at termination.

The required disclosures are triggered when covered services may be provided by a covered service provider and the covered service provider (or its affiliate or subcontractor) reasonably expects to receive payments in excess of $1,000 over the life of the contract.

An interesting note is that the regulations do not specify what the plan's fiduciary is to do with the disclosures, other than to ask for them and to take certain actions to correct a deficiency where a deficiency is discovered in the disclosures that were provided. Presumably the plan fiduciaries will evaluate the content of the disclosures and document for their own records why they engaged the service provider.

A checklist for service providers and responsible fiduciaries to use as guidance for compliance with these new requirements is available online at TaxFactsUpdates.com.

Planning Point: Because the disclosures are required in advance, and the purpose of the disclosures is to provide information on fees to be paid by a plan, the new regulations establish a minimum standard of care in evaluating all service provider arrangements. That is, plan fiduciaries will need to document what they did with the disclosures. Just filing them away will not be enough, as fiduciaries can expect that savvy participants will ask for these disclosures and all follow-up assessments. Participants suing a plan fiduciary over excessive fees will also ask for the disclosures and any documentation of what the fiduciary did with them. Thus, fiduciaries will want to confirm that they did in fact evaluate the information in the disclosure and document why they deemed the agreement to be prudent for the services provided. They also will want to retain the disclosures for proposed services from the service providers they did not hire.

3993. When does a service provider arrangement result in a prohibited transaction?

Plan fiduciaries are required to make prudent decisions regarding the use of a plan's assets to pay a plan's service providers. ERISA and the IRC impose this obligation on plan fiduciaries by creating a classification of individuals and entities known as parties-in-interest. Parties-in-interest include, but are not limited to, individuals and entities such as plan fiduciaries, service providers, the employer (and 50 percent owners of the employer) whose employees are covered by the plan and other related parties. Both ERISA and the IRC state that transactions between parties-in-interest and a plan constitute prohibited transactions unless exempted under either statute or regulations. An agreement between a service provider and plan to do enrollments, calculation of vesting, brokerage, recordkeeping, allocation of contributions, or filing of Form 5500 are prohibited transactions unless an exemption is available.[1] ERISA and the IRC are clear

1. Labor Reg. §2550.408b-2(c)(1)(i).

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that neither a plan sponsor nor a fiduciary need to show that the transaction results in adverse consequences to the plan to be considered prohibited.

Planning Point: The requirements regarding parties-in-interest and prohibited transactions are found in ERISA Sections 406(a)(1)(C) and 408(b)(2) and Internal Revenue Code Sections 4975(c)(1) and 4975(c)(1)(C). These laws have been modified over the years by various regulations. The exemptions that are available cover most of the normal services that are offered to retirement plans. These regulations do not replace any of those exemptions but focus on a process to document that the fees being paid are reasonable.[1]

A prohibited transaction exemption is generally available to a service provider arrangement when the services are necessary for the proper administration of the plan and no more than "reasonable" compensation is paid to the provider.

The regulations establish one criterion for what constitutes an arrangement where reasonable compensation is paid. The regulations refer to such an arrangement as a reasonable arrangement. To be classified as a reasonable arrangement, the disclosures identified in the regulations must be timely provided. Otherwise, the arrangement is not reasonable and the arrangement is not exempt from being treated as a prohibited transaction.

The regulations provide a way for a responsible plan fiduciary to bring deficient disclosures back into compliance. If these procedures are followed, the responsible plan fiduciary is exempted from the penalties associated with the prohibited transaction.

There is specific relief in the regulations for covered service providers who, acting in good faith and using reasonable diligence, make an error or omission in disclosing the required information. A service provider can provide the corrected disclosures within thirty days of discovery without the arrangement being treated as failing to be reasonable.

If the responsible plan fiduciary discovers that disclosures have not been made, they must request appropriate disclosure from the covered service provider within 30 days of discovery. If the covered service provider actively refuses to disclose the required information, the responsible plan fiduciary must notify the DOL within 30 days of the refusal. If the covered service provider simply does not respond to the request, the covered service provider must notify the DOL within 90 days of the request. The notice must contain the following information:

(1) The name of the covered plan and its plan number;

(2) The plan sponsor's name, address and EIN;

(3) The name, address and phone number of the responsible plan fiduciary;

(4) The name, address, phone number and, if known, the EIN of the covered service provider;

1. ERISA Sec. 406(a)(1)(c); 408(b)(2); IRC Secs. 4975(c)(1); 4975(c)(1)(C).

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(5) A description of the services provided to the covered plan;

(6) A description of the information the covered service provider failed to disclose;

(7) The date on which such information was requested in writing from the covered service provider;

(8) A statement as to whether the covered service provider continues to provide services to the plan.

The DOL has made a fee disclosure reporting failure notice available online at: http://www.dol.gov/ebsa/regs/feedisclosurefailurenotice.html

3994. Does a plan fiduciary still have to evaluate the reasonableness of compensation paid under a service provider's arrangement?

Yes.

This evaluation is done on a facts and circumstances basis following the basic requirements of ERISA that apply to all fiduciary decisions. The disclosures under these regulations are designed to provide the appropriate information to enable a responsible plan fiduciary to determine whether the fees paid for the services provider are reasonable. Best practices indicate that fiduciaries will document receipt of the disclosures and why they deemed the arrangements reasonable and prudent.

There is no bright line guidance in these regulations or in ERISA as to when a specified level of fees being paid to a service provider is unreasonable for the services being provided. The DOL, through the Employee Benefits Security Administration ("EBSA"), has provided on its website (http://www.dol.gov/ebsa/) numerous documents that discuss a fiduciary's responsibility regarding the selection of service providers. Those documents contain work sheets that may be used by a plan fiduciary to help evaluate the reasonableness of the amount of the fees being paid to a covered service provider.

Although this guidance replaces Section (c) of DOL Reg. 2550.408b-2, these regulatory changes should be read in conjunction with the full regulations under this section. In particular, see comments under termination compensation from subsection (a) and (d).[1]

3995. How can a covered service provider correct a prohibited transaction arising from a failure to timely disclose required information?

The answer to this question assumes that the service provider did not make the appropriate corrections within thirty days and that a prohibited transaction occurred. There are no IRS regulations that specify how to correct a prohibited transaction under IRC Section 4975. The IRS generally applies the prohibited transaction rules that apply to private foundations under IRC Section 4941 for which regulations have been issued. A correction under those rules

1. Preamble to Final and Interim Reg. §2550.408b-2(c), July 16, 2010.

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generally requires that the transaction be undone to the fullest extent possible, and that the plan participants be restored to the position they would have been in had the prohibited transaction not occurred. Penalties typically apply to a prohibited transaction.[1]

The 408(b)(2) regulations provide a process for a responsible plan fiduciary to request a correction of a deficient disclosure and a process for notifying the DOL if those deficiencies are not timely corrected. The regulations also state that a plan fiduciary should, on discovery of a disclosure failure, make a determination as to whether to terminate or continue the arrangement. The plan fiduciary should take into account the adverse consequences of a termination on the plan's participants as part of that determination.

It is unclear at this point as to how much, if any, of the fees received by the service provider would need to be refunded to restore the participants' accounts when the disclosures are not provided. Where payments are accelerated in the early months of the contract, it is likely that some repayment of that amount would be required if the contract is terminated. A refund of fees paid also may be required to correct the failure if the disclosure failure related directly to undisclosed fees.

3996. What penalties typically apply if there has been a prohibited transaction?

The IRS imposes both a first tier excise tax (15 percent) and a second tier excise tax (100 percent) on a prohibited transaction. The tax is applied to the amount involved in the transaction. Here, the excise tax would be applied to the payment of the fees to the service provider. The DOL likely will be providing future guidance on how and when a penalty would be imposed on prohibited transactions arising from a failure to make the proper disclosures.

The regulations provide relief to covered service providers who, acting in good faith and applying reasonable diligence, made an error or omission in disclosing the required information. A service provider that meets these conditions can provide the correct disclosures within thirty days of its discovery without the arrangement being treated as failing to be reasonable due to failure to provide adequate disclosures.

A provider whose actions do not meet this criterion may be able to take advantage of the general fourteen day correction period that applies to private foundations. Under this rule, certain prohibited transactions that are corrected within fourteen days of discovery are exempt from the penalties associated with prohibited transactions. The fourteen day correction generally is only available if the transactions do not relate to self-dealing by plan fiduciaries. It should be available for violations arising from:

(1) sale, exchange of leasing of plan assets;

(2) lending of plan assets;

(3) furnishing of good and services and facilities; and

(4) use of plan assets by a disqualified party.

1. IRC Sec. 4975.

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A failure to adequately provide a required disclosure that is corrected within fourteen days of discovery would appear to be eligible for this treatment and should not become a prohibited transaction.

The final 408(b)(2) regulations identify a process that a responsible plan fiduciary can follow when a disclosure failure has been discovered. That process, if followed, provides an exemption to a responsible plan fiduciary from the penalties of engaging in a prohibited transaction. This process does not exempt the arrangement from being a prohibited transaction.

The IRS tax qualification correction program, generally referred to as EPCRS, is not available to reduce any excise taxes such as those arising from a prohibited transaction. EPCRS is available only for correcting IRC Section 401(a) qualification failures. A prohibited transaction in and of itself is not a qualification issue.[1]

The DOL provides a correction process under its VFC Program that is available to correct a breach of fiduciary duty. This correction generally provides relief to a plan fiduciary from investigation and penalties under ERISA Sections 502(l) and 502(i). This option would be available to any plan fiduciary that did not meet the exemptions from certain prohibited transactions penalties that are provided for in the final 408(b)(2) regulations.

3997. What does a responsible plan fiduciary need to do to avoid the penalties of a prohibited transaction from a disclosure failure?

Assuming a responsible plan fiduciary was not aware of a disclosure failure, the responsible plan fiduciary will not be subject to sanctions under the prohibited transaction rules.

On discovery of the failure, however, the responsible plan fiduciary must take several actions to ensure that the proper disclosures are received. First, within 30 days of the discovery of the failure, the responsible plan fiduciary must request in writing that the service provider correct the deficiency. If the service provider does not provide the proper disclosures within 90 days of the request, the responsible plan fiduciary must provide a notice to the DOL of that failure within 30 days following the lapse of the 90 day request period. If the service provider affirmatively refuses to provide the requested information, the responsible plan fiduciary must notify the DOL within 30 days of that refusal.[2] The notice can be filed in paper format with the DOL, or by using the DOL's online fee disclosure failure notice website located at http://www.dol.gov/ebsa/regs/feedisclosurefailurenotice.html.

The notice sent to the DOL must contain certain information, including:

(1) the name of the plan and plan number listed on Form 5500;

(2) the plan sponsor's name, address and phone number;

(3) the name, address and telephone number of the responsible plan fiduciary;

1. Rev. Proc. 2008-50, Sept. 2, 2008.
2. Labor Reg. §2550.408b-2(c)(1)(ix).

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(4) the name, address, phone number, and, if known, the EIN of the service provider;

(5) a description of the services provided to the plan;

(6) a description of the deficiency in the disclosure failure;

(7) the date the written request for the correction was made by the plan fiduciary; and

(8) a statement as to whether the service provider is continuing to provide services to the plan.

Planning Point: If the covered service provider does not provide appropriate disclosures within the 90 day period, and the requested disclosures relate to future services to be provided to the plan, the responsible plan fiduciary must take action to terminate the contract as quickly as prudently possible.

3998. Are new fiduciary responsibilities imposed upon plan fiduciaries under the DOL 408(b)(2) regulations?

Other than requiring a responsible plan fiduciary to ask for appropriate disclosures from each covered service provider as well as follow specific procedures for correcting disclosure failures, the regulations do not impose any new requirements on a plan fiduciary. The receipt of the disclosure information implies that a plan fiduciary will need to review those disclosures and document an evaluation of the services and fees disclosed to ensure that they are reasonable and prudent.[1]

These regulations focus on the disclosure requirements that a covered service provider must provide for the arrangement to qualify as an exemption from a prohibited transaction. A plan fiduciary generally can rely on a service provider's representation that proper disclosures were made; assuming that the responsible plan fiduciary makes a good faith effort to ensure that the disclosures are proper. When a responsible plan fiduciary receives proper disclosures, the arrangement will be treated as meeting the requirements for the reasonable arrangement component of the exemption, provided the compensation paid is reasonable. The regulations include an exemption for a plan fiduciary being subject to prohibited transaction penalties, provided that the plan fiduciary had no reason to suspect that the disclosures were incorrect. If a plan fiduciary discovers a deficiency in the disclosures, it must request correct and accurate disclosures. If the plan does not receive the correct disclosures, the plan fiduciary then must report the service provider to the Department of Labor.

3999. What is a responsible plan fiduciary?

The final regulations define a responsible plan fiduciary as a fiduciary who has the authority to cause a plan to enter into or extend a contract or agreement with a service provider. Most plan documents assign this responsibility to the plan administrator, which, under the terms of the plan, may be the employer. The regulations do not appear to provide any special protections for fiduciaries other than a responsible plan fiduciary.[2]

1. Labor Reg. §2550.408b-2(c)(1)(ix).
2. Labor Reg. §2550.408b-2(c)(1)(viii).

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4000. What is a reasonable service provider agreement?

The stated purpose of the regulations is to address the reasonableness of a service provider's arrangement with a plan. The regulations state "no contract or arrangement for services between a 'covered' plan and a 'covered service provider' is reasonable within the meaning of ERISA Section 408(b)(2) unless the requirements of the regulation are satisfied." A reasonable arrangement, for purposes of these regulations, is one where a covered service provider provides certain required disclosures to a plan fiduciary. If the disclosures are not provided, the arrangement is not reasonable and will constitute a prohibited transaction unless properly corrected.[1] The actual details of the fees paid for the services provided must also be considered when determining whether a service provider agreement is reasonable.

4001. What are covered service providers?

A covered service provider is a service provider that enters into a contract or arrangement with a covered plan, and reasonably expects to receive $1,000 or more from the plan in either direct or indirect compensation for covered services.

For the purposes of the 408(b)(2) regulations, covered services include fiduciary services provided to the plan, fiduciary services provided to the investments held by the plan, Registered Investment Advisors ("RIAs") services, accounting, certain third party administrative services, record keeping services, brokerage services, and basically any service for which the service provider that receives indirect compensation from a plan.[2]

4002. What plan services are impacted by the 408(b)(2) regulations?

The 408(b)(2) disclosures apply only to covered services provided to ERISA retirement plans. The regulations set a *de minimis* exception that excludes providers expecting to collect less than $1,000 over the lifetime of the arrangement. The $1,000 threshold includes both direct and indirect compensation, so as a practical matter, this exception is of limited use.[3]

Just about any type of service relating to a typical 401(k) plan will be subject to the new disclosures. Certain types of services require disclosures in addition to the general disclosures required of all covered service providers. The regulations specifically discuss fiduciary (including RIA services) and non-fiduciary services.

Fiduciary Services

The two types of fiduciary services addressed in the regulations are:

(1) Fiduciary services provided directly to a plan as an ERISA fiduciary. This class of service provider generally includes organizations with discretionary control or authority concerning the plan's benefits or investments. These services are described under ERISA Section 21(2).

1. Labor Reg. §2550.408b-2(c)(1)(i).
2. Labor Reg. §2550.408b-2(c)(1)(iii).
3. Labor Reg. §2550.408b-2(c)(1)(iii).

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Planning Point: There is a trend among certain independent investment advisers to agree to be fiduciaries to a plan. This kind of service provider falls under this first category. These individuals generally refer to their services as being a co-fiduciary with a responsible plan fiduciary. These services are being promoted as a way for a plan sponsor to be relieved of certain fiduciary responsibilities relating to a plan. In some situations, these co-fiduciary arrangements actually may increase the liability for a plan sponsor that, in effect, becomes responsible for the prudent hiring and monitoring of the co-fiduciary, especially when the adviser/fiduciary has discretion over some aspect of the plan's investment or management. These fiduciary service arrangements require careful consideration of the adviser's net worth, liability insurance, and licensing history. Any agreement to share fiduciary duties with an outside party should be clearly spelled out in a contract drafted by ERISA counsel representing the plan sponsor and responsible plan fiduciary, not the service provider.

(2) The second category covers fiduciary services provided to an investment contract, product, or entity that holds plan assets or in which the plan has a direct equity investment. This group of service providers includes those who provide fiduciary services to collective trusts and certain hedge funds and private equity partnerships (except mutual fund managers) held by the plan.

RIA Services

RIA services include services provided directly to a plan by an individual or entity that is an investment adviser registered under a state law or the Investment Advisers Act of 1940. This includes all RIAs who are providing services, including those who are not doing so in a fiduciary role. RIAs providing fiduciary services to a plan are also included in the first group of fiduciary service providers above.

Non-fiduciary Services

There are two categories of non-fiduciary services that are covered services.

First are certain recordkeeping and brokerage services. This class of service provider includes recordkeeping or brokerage services that meet two requirements: (1) the services are provided to an individual account plan that permits participants or beneficiaries to direct the investment of their accounts, and (2) there is at least one designated investment option available to participants.

A designated investment alternative is any investment alternative selected by a fiduciary into which participants and beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts. The term designated investment alternative generally does not include a plan in which the only options available to participants are a brokerage window, self-directed brokerage accounts, or similar plan arrangements that enable participants and beneficiaries to select investments. This classification applies to the plan itself and not the specific services offered by the service provider. Thus, a broker working with a plan that offers a brokerage window in addition to a core of investments available to the plan fiduciary will be required to provide disclosures for the broker's service under the brokerage window.

A broker providing services to defined contribution plans who only offers access to individual brokerage accounts generally would not fall under this classification. Nonetheless, the broker's

services would require disclosure if the plan fiduciary uses a designated investment alternative ("DIA"). DIAs are a way to limit a fiduciary's liability when participants are given the right to direct the investment of their accounts.

When recordkeeping services are provided under any of the covered service classifications, certain additional disclosures are required relating to the fees paid and the costs of the recordkeeping services. If any indirect compensation is paid to a service provider that offers recordkeeping services, additional disclosures are required as to the cost and fees associated with each investment option.

The second category of non-fiduciary services includes service providers receiving indirect compensation. This category of covered services includes a broad range of other plan services, but only applies if the service provider reasonably expects to receive indirect compensation. The covered services for this purpose are accounting, auditing, actuarial, appraisal, banking, legal, valuation services, consulting (related to the development or implementation of investment policies or objectives or the selection or monitoring of service providers or plan investments), custodial, insurance, investment advisory services (for plan or participants), recordkeeping, securities or other investment brokerage services, or third party administration. The determination as to whether a service provider is in this category is based solely on whether the service provider receives indirect compensation. Most record keepers and brokerage firms receive indirect compensation and thus will be included in this class of non-fiduciary service provider as well as the other non-fiduciary classification.

The regulations define covered services to include services offered by affiliates and subcontractors of a service provider. Thus, when affiliates of service providers or subcontractors meet one of the thresholds requiring disclosure, the service provider then will be required to make specified disclosures to the responsible plan fiduciary.

4003. Are any service providers exempt from providing these disclosures to a covered plan?

Yes.

The regulations establish only five specific classes of service providers that are required to provide disclosures based on their services offered or their receipt of indirect compensation. Any service provider not falling into one of these five classifications will not be required to provide a disclosure under these regulations. However, a service provider that is not classified under one of the categories of covered provider based on the services it provides may become a covered provider if it accepts indirect compensation.

An example of a service organization that would not be a covered service provider is a law firm that drafts or amends a plan document and receives payment only directly from the plan sponsor. Another is the CPA who either audits or assembles the Form 5500 filing for the plan and whose fees are directly paid by the plan sponsor. If either of these service providers receives any indirect compensation from the plan, such as a referral fee or a disguised consulting fee, then they become a covered service provider. The general disclosures are still required

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if that referral fee or other indirect payment is paid to an affiliate or a subcontractor of the service provider.[1]

The disclosure requirements get more complex when a single service provider offers an array of services where some relate to plan activities that trigger a required disclosure and some are not related to any plan activities. Payroll processing or human resources services are examples of unrelated services and can occur with a payroll provider offering 401(k) services or a professional employee leasing company offering 401(k) recordkeeping services for a single monthly fee. Entities that offer a combination of services must provide the general disclosures required under the 408(b)(2) regulations. These organizations frequently receive revenue, or indirect compensation, from a plan's assets or from the investment managers on their 401(k) platform. This compensation is typically used to offset the costs of providing their 401(k) plan services. These multiservice providers are required to separate their plan and non-plan activities, although that may be difficult. The regulations identify "services related to plan administration and monitoring of plan activities (e.g., … payroll deductions and contributions)" as recordkeeping services requiring disclosure. Normally, one would not expect payroll services to constitute covered recordkeeping services.

Payroll-processing firms and some financial advisers who are covered providers frequently pay referral fees to accountants who provide services that might fall into one of the covered services classifications (for example, preparation of Form 5500). The payment of that referral fee from the payroll company or the financial adviser may constitute an indirect payment that would trigger a disclosure obligation for these accounting services that would not otherwise create a disclosure obligation.

4004. What disclosures will a bundled service provider need to provide?

Bundled service providers typically charge a single fee to a plan that is a combination of transaction charges, per-account charges and basis-points charges. Bundled service providers typically receive indirect compensation from the investment options offered under their bundled services. The bundled charge imposed on a plan or a plan's assets pays for a group of services such as plan documents, enrollment supports, investment material, recordkeeping, plan distributions, vesting calculations, and annual reporting.[2]

Assuming that a bundled service provider either receives indirect compensation from a plan or a plan is a participant directed plan with at least one designated investment alternative, the bundled provider will need to provide the general disclosures and certain additional disclosures as to fees and charges associated with each investment option.

Where a bundled service provider's fees for participant recordkeeping are not explicit or are offset by indirect compensation, the provider will need to provide "a good faith estimate of the cost of such recordkeeping services, including a disclosure of the methodology and assumptions

1. Labor Reg. §2550.408b-2(c)(1)(iii).
2. Labor Reg. §2550.408b-2(c)(1)(iv)(D)(2).

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used to prepare the estimate."The provider is required to provide a statement describing how they developed the good faith estimate.

Regulations require this good faith estimate for recordkeeping services, but the term "recordkeeping services" covers a multitude of activities. Under the regulations, recordkeeping services include services related to plan administration and monitoring of plan and participant and beneficiary transactions (e.g., enrollment, payroll deductions and contributions, offering designated investment alternatives and other covered plan investments, loans, withdrawals, and distributions) and the maintenance of covered plan and participant and beneficiary accounts, records, and statements.

Planning Point: Because the regulations allow a responsible plan fiduciary to request additional information on the disclosures required, several business have been created to help plan fiduciaries determine whether they have received information sufficient to make prudent decisions regarding the service provider's fee and services. The regulations do not limit the information that a responsible plan fiduciary could request, and if those requests are denied or are just late in arriving, the responsible plan fiduciary may need to report the service provider arrangement to the DOL. Thus, covered service providers will need to take appropriate steps to assure that any requests are answered in a timely manner.

4005. What are the general (or "initial") required 408(b)(2) disclosures?

All covered service providers must provide certain general disclosures that are referred to in the regulations as the "initial disclosures."There are four categories of initial disclosures. These disclosures are provided to a responsible plan fiduciary. There also are three classes of covered services requiring certain additional disclosures.

The four disclosures required of all covered service providers are a description of services provided, fiduciary status, compensation, and a description of how the compensation will be received.

(1) The first disclosure is a description of the services to be provided to the plan pursuant to the contract or arrangement. The regulations provide no bright line guidance other than that the description should be sufficient for the responsible plan fiduciary to understand what is to be done so that the responsible plan fiduciary can evaluate the reasonableness of the arrangement's fees and services.

(2) The second disclosure is fiduciary status. If applicable, the disclosure must state whether the service provider will provide or expects to provide services as a fiduciary. This notice is required if the services are to be provided directly to a plan or to an investment or entity in which the plan has a direct investment. A separate, additional statement is required if a provider expects to provide services directly to a plan as an investment adviser registered under either the Investment Advisers Act of 1940 or any state law.[1]

1. Labor Reg. §2550.408b-2(c)(1)(iv).

Planning Point: There have been several appeals court decisions on breach-of-fiduciary-duty lawsuits relating to fees paid by a plan. In some of the cases, the court looked to the agreements between the service provider and the plan to help determine if the service provider was a fiduciary. Almost all agreements today between service providers and plans have statements where the responsible plan fiduciary recognizes that the service provider is not a fiduciary to the plan. In at least one lawsuit involving a covered service provider, the court relied in part on that statement to dismiss the suit. In light of that, individuals and service organizations not acting in a fiduciary role generally will want to include in the contractual arrangement a statement that they are not acting as fiduciaries. Where a service organization is acting as a fiduciary, the disclosures in these regulations are required, including a statement that the service provider is a fiduciary.

(3) The third disclosure is a statement that describes all of the compensation the service provider expects to receive as either direct compensation, indirect compensation, compensation paid among related parties, or compensation payable on termination of the arrangement. For purposes of meeting this threshold, compensation is defined to mean anything of monetary value. A *de minimis* exception applies to non-monetary items of $250 or less received during the term of the contract or arrangement, and to total payments including direct and indirect compensation of less than $1,000.

Certain disclosures are required of specific types of compensation as described below.

With respect to direct compensation, the disclosure must describe all direct compensation, either in the aggregate or by service that the service provider reasonably expects to receive. In general, direct payments include payments made directly from a plan to a service provider in any form.

With respect to indirect compensation, the disclosure must describe the indirect compensation that the service provider expects to receive. This includes both an identification of the services for which the indirect compensation will be received and the identification of the payer of the indirect compensation. Indirect compensation is compensation that is received from any source other than the plan, the plan sponsor, the covered service provider, an affiliate of the service provider, or a subcontractor of the covered service provider.

With respect to compensation paid among related parties, the disclosure must describe all compensation that will be paid to the service provider or an affiliate or subcontractor if it is set on a transaction basis or charged directly against the plan's investments and reflected in the net value of the investments (for example, 12b-1 fees). Compensation paid on a transaction basis includes commissions, soft dollars, finder's fees, or other similar incentive compensation based on business placed or retained. This description must include an identification of the services for which such compensation will be paid and identification of the payers and recipients of such compensation. The latter must include the status of a payer or recipient as an affiliate or a subcontractor.

Bundled providers that provide multiple services under one arrangement will be able to disclose their revenues on a bundled, or aggregate, basis. As described below, however, if a service provider agreement includes recordkeeping as part of its bundled services and the expected cost

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of those services is not part of the disclosure agreement, additional disclosures must be made, including a good faith estimate of the explicit cost to provide those services and a description of how that estimate was developed.

With respect to termination compensation, the disclosure must describe any compensation that the service provider reasonably expects to receive in connection with termination of the contract or arrangement. The statement must include a description of how any prepaid amounts will be calculated and refunded on termination. The regulations go on to say that "[a] provision that reasonably compensates the service provider for loss of early termination of the contract is not a penalty."

Planning Point: At the end of the regulations is a statement that "no contract or agreement is reasonable within the meaning of ERISA [S]ections 408(b)(2) and DOL regulations 2550.408b-2(a)(2) if it does not permit termination by the plan without penalty to the plan on reasonably short notice under the circumstances to prevent the plan from becoming locked into an arrangement that has become disadvantageous." These provisions could have a significant impact on certain insurance contracts and mutual funds that impose back end charges that are triggered on termination or early sale of an investment. Look for additional guidance on the application of this component of the regulations.

(4) The fourth disclosure is a description of how the expected compensation will be received by the service provider. For example, the disclosure must explain whether revenues will be billed directly to the plan, whether amounts will be deducted directly from the plan's investments, or whether the service provider will impose a basis point charge on assets under its direction.

4006. How is a service provider's expected compensation to be disclosed?

The regulations give service providers latitude in how they disclose the compensation they receive. A fiduciary who needs more information to ascertain the reasonableness of an agreement would request such information in accordance with the notification process in the regulations. The fee disclosures may be an estimate of the compensation and can be expressed as a monetary amount, formula, percentage of the covered plan's assets, a per capita charge for each participant or beneficiary, or, if the compensation cannot reasonably be expressed in these terms, by any other reasonable method. This disclosure, in whatever form it is provided, must contain sufficient information to permit evaluation of the reasonableness of the compensation by the responsible plan fiduciary.[1]

Practice Point: Since the effective date of the final 408(b)(2) regulations, the Department of Labor has been reviewing service provider's disclosures and has proposed an amendment to the regulations which would now require that plan sponsors issue a "guide" to their disclosure packages. The guide is designed to allow plan fiduciaries to quickly and easily find their specific disclosures in what has proven to be voluminous pages of paperwork plan service providers have used as their disclosure packages.

1. Labor Reg. §2550.408b-2(c)(1)(iv)(E).

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4007. What additional disclosures are required for fiduciaries and covered service providers who provide investment and recordkeeping services?

Investment Disclosure

Fiduciaries providing services to an investment or entity into which the plan invests must disclose the following types of information:[1]

(1) A description of all compensation that will be charged directly against the amount invested in connection with the acquisition, sale, transfer of, or withdrawal from the investment contract, product, or entity, for example, sales loads, sales charges, deferred sales charges, redemption fees, surrender charges, exchange fees, account fees, and purchase fees;

(2) A description of the annual operating expenses (for example, the expense ratio), but only if the return on the investment is not fixed; and

(3) A description of any ongoing expenses in addition to annual operating expenses (for example, wrap fees, mortality, and expense fees). In most cases these disclosures will be met through another service provider that will be providing the information to the responsible plan fiduciary. Organizations providing this type of information include fiduciaries for entities such as collective trusts, partnerships, and hedge funds.

Recordkeeping Services

When a covered service provider provides any recordkeeping services, certain additional disclosures are required. The regulations define recordkeeping services to include any "services related to plan administration and monitoring of plan and participant and beneficiary transactions (e.g., enrollment, payroll deductions and contributions, offering designated investment alternatives and other covered plan investments, loans, withdrawals and distributions); and the maintenance of covered plan and participant and beneficiary accounts, records, and statements."[2]

These disclosures must include:

(1) A description of all direct and indirect compensation that the service provider, an affiliate, or a subcontractor reasonably expects to receive in connection with the recordkeeping services;

(2) If the service provider reasonably expects the recordkeeping services to be provided, in whole or in part, without explicit compensation for such recordkeeping services or when compensation for recordkeeping services is offset or rebated based on other compensation received, an additional disclosure is to be provided. The service provider must provide a reasonable and good faith estimate of the

1. Labor Reg. §2550.408(b)-2(c)(1)(iv)(F).
2. Labor Reg. §2550.408(b)-2(c)(1)(iv)(G).

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cost to the plan of such recordkeeping services without offset that includes both an explanation of the methodology and assumptions used to prepare the estimate. This estimate shall take into account either (1) the rates that the covered service provider would charge to perform these services or that they would be for a third party, or (2) the prevailing market rates charged for similar recordkeeping services for a similar plan with similar number of participants.

Planning Point: These specific disclosures will be required for most bundled service providers that provide multiple services and are paid in whole or in part through indirect compensation (for example, 12b-1 fees and sub-transfer agency fees). Under this disclosure requirement, a recordkeeper that receives indirect compensation and then offsets the amount received against the provider's stated fee, or that gives credits against its recordkeeping fees, must disclose the reasonable charge for those services as if there was no revenue sharing being paid.

Planning Point: This level of disclosure will impact bundled providers that have provided provide certain settlor services on a no charge basis while at the same time collecting indirect compensation for other plan services. These regulations seem to be prohibiting such a provider from offering any free services when the provider receives indirect compensation. An interesting fallout may be that plan sponsors will need to start paying for their document services when a plan is set up. A plan sponsor may not offset the cost to perform settlor services with any revenue sharing because a plan cannot pay settlor costs. Settlor services include drafting the initial plan document and making plan amendments that primarily benefit the employer.

Investment Disclosure for Certain Participant Directed Plans

Where recordkeeping and brokerage services are provided to a plan in which the participants have at least one designated investment option available to them, or where indirect compensation is being paid by the plan, a separate disclosure is required for each designated investment option available. This disclosure must include the same investment information that is required for fiduciaries that provide services to investments in which the plan invests, as explained above.[1]

4008. What is the required format for the disclosures that service providers must make under the DOL regulations?

The regulations do not require a service provider to follow a specific format in how it discloses required information. One document or several may be involved, especially when a prospectus is available for certain of the investment disclosures.

All disclosures must provide the information in a manner that can be understood by the responsible plan fiduciary and participants.[2]

Planning Point: In March of 2014, the Department of Labor released a Proposed Amendment to 408(b)(2) Regulation which, if finalized, will require plan service providers to provide a "guide" to their 408(b)(2) disclosures if the service provider discloses the appropriate information through "multiple or lengthy documents." The DOL does not give an exact number of pages that would constitute a "lengthy" document, but it is assumed that any final amendment to the regulations would specify an exact number.

1. Labor Reg. §2550.408b-2(c)(1)(iv)(G).
2. Labor Reg. §2550.408b-2(c)(1)(iv)(E).

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The guide to the disclosures would need to be provided with the initial 408(b)(2) disclosures and would act as an index to the longer disclosures, allowing plan fiduciaries to quickly identify the information required by the regulations. The guide must include specific lookup references by identifying the page number and document in which the following information can be found:

1) Description of the services to be provided

2) Statement concerning services to be provided as a fiduciary and/or as a registered investment provider

3) Description of all direct and indirect compensation, any compensation that will be paid among related parties, compensation for termination of the contract or arrangement, as well as compensation for recordkeeping services; and

4) The required investment disclosures for fiduciary services and recordkeeping and brokerage services, including annual operating expenses and ongoing expenses, or if applicable, total annual operating expenses.

4009. When must covered service providers make the 408(b)(2) disclosures required under the DOL regulations?

A service provider must deliver the required information before the agreement or contract is consummated. Provider relationships in existence on July 1, 2012 were required to deliver the appropriate disclosures by that date. That is, there is no grace period for meeting these requirements where contracts already were in place on the effective date of the regulations.[1]

4010. Are covered service providers required to make any subsequent disclosures after the initial disclosure is provided as mandated by the DOL regulations?

A covered service provider is required to disclose any change to a responsible plan fiduciary as soon as is practicable but not later than sixty days from the date the service provider is aware of the change. Where such disclosures are late due to circumstances beyond the control of the service provider, the information must be disclosed as soon as practicable.[2]

In addition, if a responsible plan fiduciary requests information that is necessary to comply with a reporting requirement or is required for its own evaluation of the arrangement, a service provider must furnish that information. The preamble to the regulations discusses the additional information a responsible plan fiduciary may need to acquire to carry out the required duties. The regulations discuss the need for a service provider to promptly provide information that is requested. In this regard, a service provider must disclose the information no later than thirty days following receipt of a written request from a responsible plan fiduciary unless the disclosure is delayed due to extraordinary circumstances beyond the service provider's control, in which case the information must be provided as soon as practicable.[3]

1. Labor Reg. §2550.408b-2(c)(1)(iv)(E).
2. Labor Reg. §2550.408b-2(c)(1)(v)(B).
3. Labor Reg. §2550.408b-2(c)(1)(v)(A).

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4011. Do the final regulations provide any protection for a responsible plan fiduciary if a covered service provider does not provide the required disclosures?

In addition to requiring covered service providers to disclose their compensation and service arrangements, a responsible plan fiduciary is responsible for collecting these disclosures from service providers. The regulations provide an exemption permitting a responsible plan fiduciary to escape prohibited transaction liability if a covered service provider does not provide the required disclosures.

For a responsible plan fiduciary to be exempt from the prohibited transaction rules under these disclosure regulations, a plan fiduciary must not know that a covered service provider failed to provide complete disclosure. If a fiduciary discovers that a covered service provider has not fully disclosed its compensation arrangements, a responsible plan fiduciary must request that the covered service provider make full and complete disclosures. If, after ninety days after the date of the request, the service provider has failed to comply with the disclosure request, the responsible plan fiduciary then is required to report the failure to comply with the disclosure requirements to the DOL within thirty days of the service provider's refusal to comply with the request, or ninety days after the request for complete disclosure was made.

On the failure or refusal to respond to the request for disclosure, the responsible plan fiduciary must evaluate the nature of the failure, the availability, qualifications, and cost of replacement service providers, and the covered service provider's response to notification of the failure.

Planning Point: If the requested information relates to future services and is not disclosed promptly after the end of the 90 day period, the responsible plan fiduciary is required to terminate the arrangement with the covered service provider prudently and as soon as practically possible.

4012. What disclosures are required of a broker who sells a security to a defined benefit pension plan?

Whether a disclosure is required in any factual situation will be based on whether a plan is a covered plan and whether brokerage services fall into one of the covered categories of services. If a broker is selling a security to a covered plan with no participant direction, such as a defined benefit pension plan, and the broker or an affiliate is not receiving any indirect compensation, then the broker's services do not fall into any of the five categories identified in the regulations. So long as a broker is not acting as a fiduciary to a plan, no disclosure is required.[1]

If a broker also provides assistance on enrollments, distributions, and participant loans, then the broker could be providing a service classified as recordkeeping services. There still are no disclosures assuming the factors above and that the plan is a defined benefit pension plan. The triggering event for disclosure of recordkeeping services occurs when a plan has a designated investment alternative or a broker, affiliate, or subcontractor of a broker receives indirect income. The same results would apply if a plan was a profit sharing plan without participant

1. Labor Reg. §2550.408b-2(c)(1)(ii).

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directed investment, so long as there is no payment of indirect income to a broker, affiliate, or subcontractor.

If a broker instead sells a mutual fund to a defined benefit pension plan and the mutual fund pays indirect compensation to the broker or the brokerage firm, then the broker falls into the category triggered by receipt of indirect compensation and certain disclosures relating to the indirect compensation are required. If a broker also provides recordkeeping services, then the broker must provide the disclosures for recordkeeping services.

4013. What disclosures are required if a broker sells securities to a 401(k) plan?

Brokerage services are covered services required to disclose their compensation arrangements under Section 408(b)(2) if the services are provided to an individually directed plan where one or more designated investment alternatives are made available. Essentially, if a plan offers a menu of investments in which participants must invest, then the services would be covered services that trigger the disclosure obligations under the regulations. If a plan permits individually directed accounts but does not have designated investment alternatives, the plan may not be required to provide disclosures under the recordkeeping and brokerage sections of the DOL regulations.

The disclosure requirements apply even if a broker is not selling the designated investment alternative to a plan. This situation could arise in the case of a broker working with a single participant who has elected to use a window allowing the participant to buy securities outside the plan's core funds available to other participants. Because the plan has a core group of investments, it is treated as having a designated investment alternative. If a broker also assists with distributions, loans, calculation of vesting, or enrollments, additional disclosures will be required for these recordkeeping services.[1]

4014. What disclosures are required of a CPA who reconciles a plan's participant records?

No disclosures are required if the plan does not allow for investment direction by participants, the CPA is paid by the employer, and the CPA does not have a subcontractor or affiliate who receives indirect compensation from the plan.

If this CPA makes a referral to a payroll provider that provides 401(k) recordkeeping services, and the payroll provider that then handles the 401(k) plan pays a referral fee or a disguised consulting fee to the CPA, then the CPA will need to report as a service provider who receives indirect compensation.

If a plan has participant direction and has at least one designated investment alternative or a QDIA, a CPA will be treated as providing recordkeeping services. Then, the general disclosures are required under the covered service classification of recordkeeper. A CPA also may need to provide certain other disclosures based on how it gets paid and the services provided.

1. Labor Reg. §2550.408b-2(c)(1)(ii).

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Some CPAs have staff that are investment advisers and are registered under state law or the Investment Adviser's Act of 1940. If these advisers provide services to a plan, then they must provide both the general disclosures and certain additional disclosures based on the type of services that are provided to the plan and the structure of the plan.

If a CPA firm has an affiliate such as an investment advisory group that receives indirect compensation from the plan, then the general disclosures will be required.

4015. What disclosures are required of a 401(k) plan's third party recordkeeper?

A recordkeeper is required to provide disclosures if it receives indirect compensation or if the plan has a designated investment alternative. Most recordkeepers that work with mutual fund investments receive indirect compensation from the funds in the form of sub-transfer agency fees and other revenue sharing or indirect compensation, as well as direct compensation in the form of fees for participant transactions such as loan maintenance or distributions.

If a covered service provider is offering recordkeeping services for free or expects the services to be provided without explicit compensation, the recordkeeper is required to provide the responsible plan fiduciary with a good faith estimate as to the cost of the recordkeeping services that will be provided. The estimate for recordkeeping services must take into account the rates that a covered service provider would normally charge to a plan to perform the recordkeeping or the prevailing market rates charged for similar recordkeeping services for a similar plan with a similar number of covered participants and beneficiaries.

Planning Point: Practically, this disclosure requirement will most affect bundled providers that sell their recordkeeping services as free to be made up with higher investment costs in other places.

4016. What is the purpose of the Department of Labor ("DOL") Section 404(a)(5) participant disclosure regulations?

With the proliferation of 401(k) and profit sharing plans that permit plan participants to individually direct their retirement plan assets, the DOL has grown exceedingly concerned about plan participants being required to make investment decisions without having access to information concerning the account fees and expenses.

When a plan permits participants to direct their investments, the regulations require that the plan administrator take action to inform the plan participants of the rights and responsibilities afforded to each participant with the ability to direct their investments. These disclosures must be provided prior to the date on which a participant or beneficiary can first direct the investments in their account and on a regular and periodic basis thereafter. Information required includes, but is not limited to, fees and expenses, voting rights, and rights associated with the direction of investments. For calendar year plans, the initial participant disclosures were required to be distributed by August 30, 2012, and at least annually thereafter. In addition, the first quarterly disclosures under these regulations were required to be distributed by November 14, 2012, as well as quarterly thereafter.

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In contrast to the 408(b)(2) covered service provider disclosures, a plan that does not comply with the plan participant disclosure requirements does not run the risk of violating the prohibited transaction rules, but may be found to be in breach of its fiduciary duty. Since the plan participant disclosure requirements do not run up against the prohibited transaction rules, the participants will first need to suffer losses before liability for failure to comply accrues.

4017. What plans do the 404(a)(5) participant fee disclosures apply to?

To meet their fiduciary duties, the plan administrator of "covered individual account plans" must comply with the disclosure requirements of Section 404(a)(5).

Covered individual account plans include any defined contribution plan (as defined by Section 3(34) of ERISA) which permits plan participants or beneficiaries to direct investment of their plan assets. If a plan participant or beneficiary is permitted to direct only a portion of their account balance, while another portion of the account balance is trustee directed, the plan fiduciary need only comply with the disclosure requirements with respect to the assets that the plan participant has the right to direct.

SEPs, SIMPLEs, and defined benefit plans are not subject to these disclosure requirements.

The disclosures must be made to the plan participants or beneficiaries who have the right to direct their investments under the plan.

4018. What information must be disclosed to plan participants under the 404(a)(5) regulations?

The disclosures required under these regulations can be broken down into two over-arching categories: *plan-related information* and *investment-related information*.

Plan-related information must include disclosures describing:

(1) "General Information" consisting of information concerning the structure and mechanics of the plan;

(2) "Administrative Expenses" consisting of any fees and expenses for general plan administrative services that may be charged against all individual accounts; and

(3) "Individual Expense Information" consisting of any fees and expenses that may be charged to each individual participant's account due to actions taken by that participant.

The plan-related information disclosures must be provided to plan participants on or before the date they are first eligible to direct their investments, and then annually thereafter. On a quarterly basis, plan participants must receive notice of the actual charges relating to these plan-related fees and expenses charged to their account in the preceding quarter.

Investment-related information must include disclosures regarding any default investment option under the plan and describing:

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(1) Performance data concerning historical investment performance for 1, 5, and 10-year returns for investment options that do not have fixed rates of return;

(2) Benchmarking against an appropriate broad-based securities index over 1, 5, and 10 years for investment options without a fixed rate of return;

(3) Fee and expense information for investments without a fixed rate of return must be expressed as both a percentage of assets and as a dollar amount for each $1,000 invested, as well as fees and restrictions on the ability to purchase or withdraw from the investments. For fixed rate of return investments, only shareholder-type fees or restrictions on the purchase or withdrawal from the investment need be disclosed;

(4) A website address where participants can access information that is sufficiently specific to provide participants with additional information about the investments; and

(5) A glossary of terms that will assist participants in understanding the plan's investment options. Plan administrators can provide this information in the form of a website address that is sufficiently specific to provide access to such a glossary.

Investment-related return information must be furnished to participants in a chart or similar format designed to encourage a comparison of each investment option available under the plan. The information that must be disclosed pursuant to these disclosure requirements is discussed in detail in Q 4022.

4019. What information must be included in the "general disclosures" section of a 404(a)(5) disclosure?

On or before the date that a plan participant or beneficiary can first direct their investments, and annually thereafter, the plan administrator must provide them with "General Disclosures" describing:

(1) An explanation of the circumstances under which participants and beneficiaries may give investment instructions;

(2) An explanation of any specified limitations on such instructions under the terms of the plan, including any restrictions on transfer to or from a designated investment alternative;

(3) A description of or reference to plan provisions relating to the exercise of voting, tender, and similar rights appurtenant to an investment in a designated investment alternative as well as any restrictions on such rights;

(4) An identification of any designated investment alternatives offered under the plan;

(5) An identification of any designated investment managers; and

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(6) A description of any "brokerage windows," "self-directed brokerage accounts," or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by the plan.

If there are any changes to the disclosed information, the participant or beneficiary must be given notice of the change at least 30, but no more than 90 days, before the effective date of the change. However, if circumstances present themselves to prevent disclosing changes to this information within the appropriate time frame, the plan administrator must issue a notice describing the changes as soon as practicable.

4020. What information relating to administrative expenses must be included in a 404(a)(5) disclosure?

On or before the date on which a participant or beneficiary can first direct their investments, and on an annual basis thereafter, the administrative expenses of the plan that may be charged against a participant or beneficiary's account must be disclosed to the extent that the charge is not included in the annual operating expense of any designated investment alternative. Recordkeeping, accounting, or legal services are examples of expenses that may need to be disclosed relating to administrative expenses. The plan administrator must also disclose the method in which the amount for services will be deducted from the participants' account balance, whether it is on a pro-rata, per capita, or a flat dollar basis.

The disclosures must be written in such a manner as to be understood by the average plan participant. If the fees for a service are known at the time of the disclosure, the plan administrator must identify the service provided, the cost of the services, and the allocation method used. In DOL Field Assistance Bulletin 2012-02R, the following examples of fee disclosures were found to be consistent with the DOL's disclosure requirements:

> *Example 1:* The plan divides total recordkeeping costs equally among all individual accounts so that each participant or beneficiary with a plan account will pay $25.00 per year. One fourth of this amount is subtracted from each individual plan account each quarter.
>
> *Example 2:* An annual recordkeeping fee of .12% of the account balance will be charged to each individual plan account. Each month, an amount equal to .01% of the account's ending balance for the month will be deducted from your individual account.
>
> *Example 3:* An annual recordkeeping fee of .12% of the account balance will be charged to each individual plan account. Each month, an amount equal to .01% of the account's ending balance for the month will be deducted from your individual account. For example, if your ending account balance for a month is $55,000, then $5.50 will be deducted for that month.

If the actual fees or services are not known at the time of disclosure, and the plan administration reasonably expects the fees for services to be incurred and paid out of plan assets, the disclosures must describe the services that it expects to be provided and how the charges will be allocated to each participant's account. As an example, "if the plan incurs any legal expenses, such expenses will be paid from the plan's assets and deducted from individual plan accounts on a pro-rata basis" would be an appropriate disclosure for this scenario.

On a quarterly basis, the plan administrator must provide the plan participant or beneficiary with the actual dollar amount of the fees and expenses deducted from the participant's account for the provision of administrative services for the prior quarter, as well as a description of the services to which the charges relate. If applicable, the plan administrator must also disclose whether some of the plan's administrative expenses from the preceding quarter were paid from the total annual operating expenses of one or more of the plan's designated investment alternatives (e.g. revenue sharing arrangements, 12b-1 fees, sub-transfer agent fees).

If there are any changes to the disclosed information, the participant or beneficiary must be given notice of the change at least 30 but no more than 90 days before the effective date of the change. However, if circumstances present themselves to prevent disclosing changes to this information within the appropriate time frame, the plan administrator must issue a notice describing the changes as soon as practicable.

4021. What information must be disclosed relating to individual expenses under the 404(a)(5) disclosure regulations?

On or before the date on which a participant or beneficiary can first direct plan investments, and annually thereafter, the plan administrator must disclose any fees and expenses that can be charged against the participant's investment account for services provided on an individual basis. Examples for which this disclosure would apply include loan fees, QDRO processing, or distribution fees.

On a quarterly basis, the plan administrator must provide the participants or beneficiaries an accounting of the dollar amount of the fees and expenses charged against the account for individual services deducted in the preceding quarter, as well as a description of the services provided.

If there are any changes to the disclosed information, the participant or beneficiary must be given notice of the change at least 30 but no more than 90 days before the effective date of the change. However, if circumstances present themselves to prevent disclosing changes to this information within the appropriate time frame, the plan administrator must issue a notice describing the changes as soon as practicable.

4022. What disclosures must be made with respect to investment-related information under the 404(a)(5) disclosure regulations?

Automatic Disclosures

On or before the date on which a participant or beneficiary can first direct their investments, and on an annual basis thereafter, the plan administrator must disclose certain investment-related information concerning each designated investment alternative offered under the plan.

For each designated investment alternative offered (see Q 4023), the plan administrator must disclose the following items in a comparative chart format designed to facilitate a comparison of such information for each designated investment:

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(1) The name of the investment;

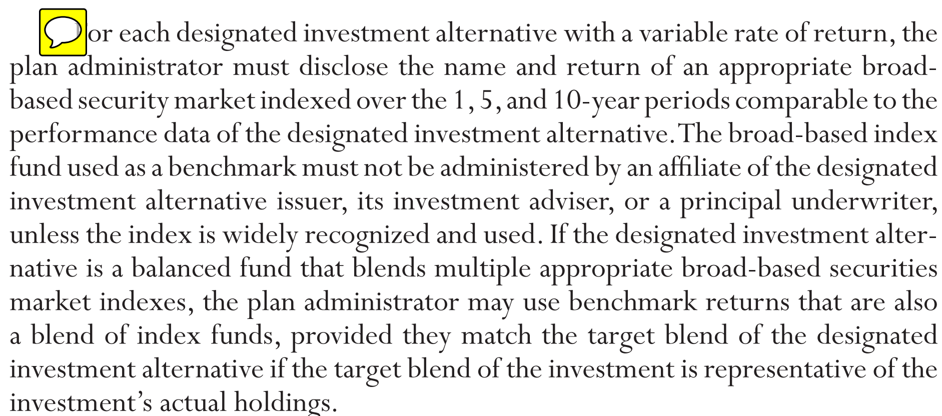
(2) The type or category of the investment (e.g., money market fund, balanced fund (stocks and bonds), large-cap stock fund, employer stock fund, employer securities);

(3) Performance data.

For designated investment alternatives with a variable rate of return, the plan administrator must disclose the average annual total return of the investment for 1, 5, and 10-year calendar periods ending on the date of the most recently ended calendar year. The plan administrator must also disclose that an investment's performance is not necessarily an indication of how the investment will perform.

For designated investment alternatives with a fixed rate of return, the plan administrator must disclose both the fixed or stated annual rate of return and the term of the investment. If the issuer of the fixed rate of return investment reserves the right to adjust the fixed or stated rate of return prospectively during the term of the contract, the disclosure must include the current rate of return, the minimum guaranteed rate under the contract, and a statement advising participants and beneficiaries that the issuer may adjust the rate of return prospectively along with information on how to obtain the most recent rate of return.

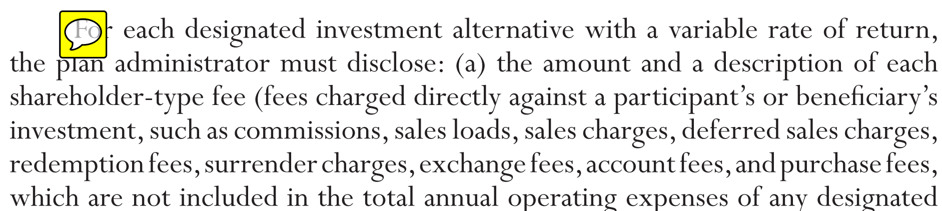
(1) Benchmarks:



For each designated investment alternative with a variable rate of return, the plan administrator must disclose the name and return of an appropriate broad-based security market indexed over the 1, 5, and 10-year periods comparable to the performance data of the designated investment alternative. The broad-based index fund used as a benchmark must not be administered by an affiliate of the designated investment alternative issuer, its investment adviser, or a principal underwriter, unless the index is widely recognized and used. If the designated investment alternative is a balanced fund that blends multiple appropriate broad-based securities market indexes, the plan administrator may use benchmark returns that are also a blend of index funds, provided they match the target blend of the designated investment alternative if the target blend of the investment is representative of the investment's actual holdings.

Note that there are no benchmarking requirements for designated investment alternatives that have fixed rates of return.

(2) Fee and expense information:



For each designated investment alternative with a variable rate of return, the plan administrator must disclose: (a) the amount and a description of each shareholder-type fee (fees charged directly against a participant's or beneficiary's investment, such as commissions, sales loads, sales charges, deferred sales charges, redemption fees, surrender charges, exchange fees, account fees, and purchase fees, which are not included in the total annual operating expenses of any designated

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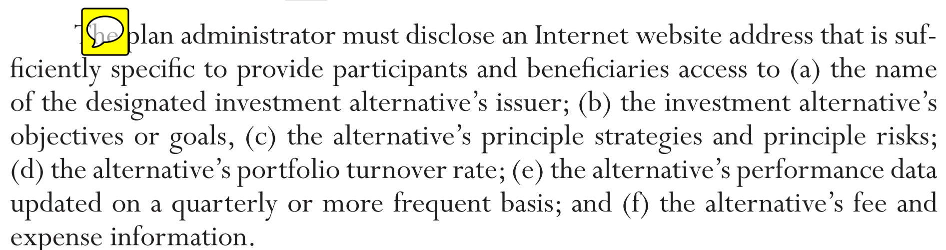
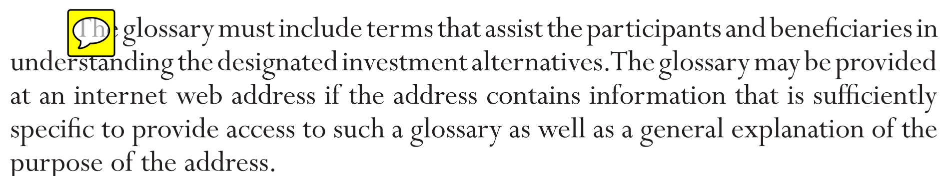
investment alternative) and a description of any restriction or limitation that may be applicable to a purchase, transfer, or withdrawal of the investment in whole or in part (such as round trip, equity wash, or other restrictions); (b) the total annual operating expenses of the investment expressed as a percentage (expense ratio); (c) the total annual operating expenses of the investment for a 1-year period expressed as a dollar amount per $1,000 investment; (d) a statement indicating that the fees and expenses are only one of several factors that participants and beneficiaries should consider when making investment decisions; and (e) a statement that the cumulative effect of fees and expenses can substantially reduce the growth of a participant's or beneficiary's retirement account, and that participants and beneficiaries can visit the Employee Benefit Security Administration's website for an example demonstrating the long-term effect of fees and expenses.

(3) Internet website address



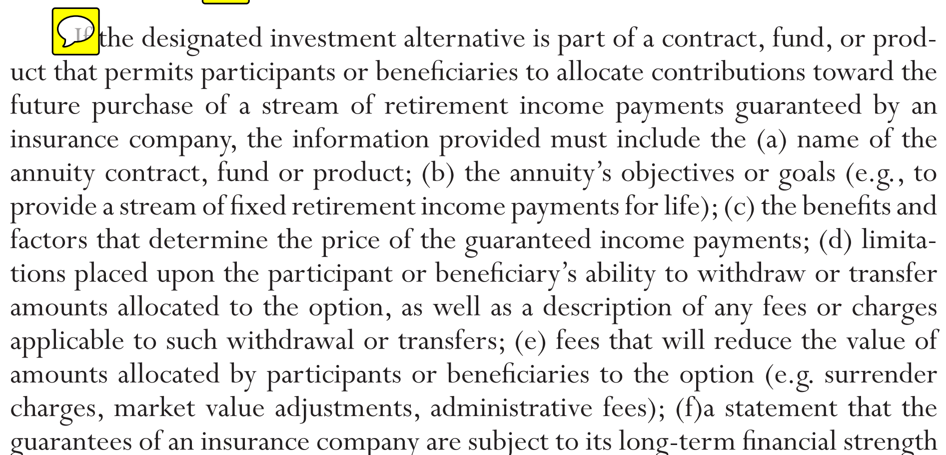
The plan administrator must disclose an Internet website address that is sufficiently specific to provide participants and beneficiaries access to (a) the name of the designated investment alternative's issuer; (b) the investment alternative's objectives or goals, (c) the alternative's principle strategies and principle risks; (d) the alternative's portfolio turnover rate; (e) the alternative's performance data updated on a quarterly or more frequent basis; and (f) the alternative's fee and expense information.

(4) Glossary



The glossary must include terms that assist the participants and beneficiaries in understanding the designated investment alternatives. The glossary may be provided at an internet web address if the address contains information that is sufficiently specific to provide access to such a glossary as well as a general explanation of the purpose of the address.

(5) Annuity Options



If the designated investment alternative is part of a contract, fund, or product that permits participants or beneficiaries to allocate contributions toward the future purchase of a stream of retirement income payments guaranteed by an insurance company, the information provided must include the (a) name of the annuity contract, fund or product; (b) the annuity's objectives or goals (e.g., to provide a stream of fixed retirement income payments for life); (c) the benefits and factors that determine the price of the guaranteed income payments; (d) limitations placed upon the participant or beneficiary's ability to withdraw or transfer amounts allocated to the option, as well as a description of any fees or charges applicable to such withdrawal or transfers; (e) fees that will reduce the value of amounts allocated by participants or beneficiaries to the option (e.g. surrender charges, market value adjustments, administrative fees); (f)a statement that the guarantees of an insurance company are subject to its long-term financial strength

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and claims-paying ability; and (g) a website address sufficiently specific to provide the information contained in items (a) through (f) above.

Information to be Provided Subsequent to Investment

Subsequent to investment in any designated investment alternative, to the extent that voting, tender and similar rights are passed through to a participant or beneficiary of the plan, the plan administrator must furnish to the participant and beneficiary any materials provided to the plan relating to the exercise of voting, tender and similar rights.

Information to be Provided upon Request

Upon request of the participant or beneficiary, the plan administrator must provide a copy of any prospectuses (or short-form or summary prospectus), a copy of any financial statement or report relating to the designated investment alternative to the extent they were provided to the plan as well as a statement of the value of a share or unit of each designated investment alternative on the date of valuation.

4023. What is a designated investment alternative?

A designated investment alternative is any investment alternative designated by the plan into which participants and beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts. Designated investment alternatives do not include "brokerage windows," "self-directed brokerage accounts," or similar plan arrangements that permit plan participants and beneficiaries to select investments beyond those designated by the plans.

Generally, a model portfolio is not considered a designated investment alternative if it is clearly presented to the participants and beneficiaries as merely a means of allocating account assets among specific designated investment alternatives. However, if in choosing a model portfolio, the plan participant acquires an equity security, unit participation, or similar interest in an entity that invests in some combination of the plan's designated investment alternatives, the model portfolio would then be considered a designated investment alternative.

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