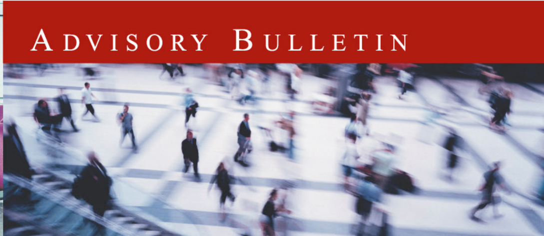

ADVISORY BULLETIN

July 2011

EMPLOYEE BENEFITS AND INVESTMENT MANAGEMENT UPDATE

Thompson Hine's employee benefits and investment management lawyers understand the challenges of complying with the regulatory requirements associated with sponsoring and providing services to retirement plans. We work closely with clients in monitoring the changing regulatory requirements associated with retirement plan administration. The breadth and depth of our experience allows us to identify best practices as they emerge and provide responsive, legally compliant and cost-effective solutions.

New Retirement Plan Disclosures – Are You Ready?

2010 brought a flurry of regulatory activity from the Department of Labor (DOL), including the issuance of two final regulations focused on retirement plan fee disclosure: an interim final regulation requiring that certain service providers to most retirement plans provide plan sponsors advance disclosure of fees and services, and a final regulation requiring that plan administrators to 401(k) plans (and other similar plans) provide plan participants with periodic disclosures of certain general plan terms, fee information and investment-related information.

These regulations will impose significant disclosure obligations on service providers, plan sponsors and plan administrators. Provisions of the new regulations require compliance beginning at various times in 2012. This bulletin provides an outline of the requirements of the new regulations and steps recommended to assure compliance.

SERVICE PROVIDER DISCLOSURE REQUIREMENTS

Background. ERISA requires that retirement plan sponsors monitor arrangements with, and compensation paid to, plan service providers to ensure that such arrangements, and the compensation paid pursuant to those arrangements, are "reasonable." Although the service provider disclosure regulation does not modify the requirement to evaluate whether compensation is "reasonable," the regulation mandates certain disclosures as a prerequisite to reasonableness.

Who is subject to disclosure? The regulation applies to certain service providers to most retirement plans (other than SEPs, SIMPLE IRAs, IRAs, governmental plans, non-electing church plans and certain nonqualified plans). The following types of retirement plan service providers who have a direct contract or arrangement with a covered retirement plan and expect to receive $1,000 or more in fees (directly or indirectly) are subject to the disclosure requirements:

- *Fiduciaries.* Service providers with administrative discretion and/or investment discretion.

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- *Plan asset managers.* Managers of any investment vehicle that holds "plan assets" (within the meaning of ERISA) and in which the plan holds an equity interest.[1]
- *Investment advisers.* Registered investment advisers, whether or not fiduciaries.
- *Platform providers.* Providers of brokerage or recordkeeping services to participant-directed individual account plans that make at least one investment alternative available as an investment option to participants.
- *Other service providers.* Most other service providers that expect to receive indirect compensation (compensation from a source other than the plan, plan sponsor, covered service provider, an affiliate or subcontractor) or related party compensation (certain compensation paid among the service provider and its affiliates and subcontractors).

Affiliates (including subsidiaries and parent companies) and subcontractors of the service provider who provide services solely on behalf of a covered service provider are not required to provide fee disclosures. However, the service provider must disclose fees received by affiliates and/or subcontractors.

When is disclosure required? The regulation becomes effective April 1, 2012. Thus, for contracts or arrangements in existence before April 1, 2012, the disclosures must be provided by April 1, 2012. With respect to contracts or arrangements entered into, extended or renewed on or after April 1, 2012, the service provider must provide the disclosures reasonably in advance of the date the covered service provider enters into, renews or extends the contract or arrangement with the plan. Updated disclosures are required if changes occur to the services provided or the compensation received for such services.

What must be disclosed? Service providers must disclose the following information:

- *Description of services.* A description of the services expected to be provided to the plan under the contract or arrangement.
- *Description of compensation.* A description of the compensation the service provider (and its affiliates and subcontractors) reasonably expects to receive for services under the contract or arrangement. The level of detail of the disclosures varies based on the type of compensation expected: direct, indirect or related party compensation.
- *Compensation at termination of contract or arrangement.* A description of any compensation expected to be received by the service provider when the contract or arrangement is terminated, and how any refund of pre-paid fees will be calculated and paid.
- *Manner of payment.* A description of the manner in which compensation will be received by the service provider, such as whether the plan will be billed or whether fees will be deducted from plan accounts.

Additional disclosures for recordkeeping services. Recordkeepers must separately disclose the direct and indirect compensation that they expect to receive for recordkeeping services. Service providers that provide recordkeeping services for "free" in connection with other services (such as investment management) must disclose a reasonable and good faith estimate of the cost of the recordkeeping services, including the methodology and assumptions used to determine the estimate.

Additional investment-related disclosures. Plan asset managers serving as fiduciaries and recordkeeper/brokers that provide participant investments must also disclose any fees that will be charged related to the acquisition, sale, transfer of or withdrawal from the investment; the annual operating expenses of the investment, if the return is not fixed (i.e., the expense ratio); and any additional ongoing expenses (e.g., wrap fees and mortality fees). For example, a recordkeeper providing investment options must disclose the expense ratio for each investment option and all applicable transfer fees.

Fiduciary/investment adviser statement. If a service provider (or an affiliate or subcontractor of the service provider) expects to be a fiduciary or investment adviser to the plan, then the service provider must include a statement in its disclosure that it is a fiduciary or investment adviser. Plan asset managers who are fiduciaries are subject to this disclosure.

Participant Disclosure Regulation

Background. The Participant Disclosure Regulation requires the plan administrator of a participant-directed individual account plan such as a 401(k) plan to make periodic disclosures of plan and investment-related information to plan participants and beneficiaries. The purpose of the regulation is to enhance the information in the hands of plan participants and beneficiaries to enable them to make better informed decisions regarding their investments in the plan.

To whom does the regulation apply? The regulation imposes disclosure obligations on the plan administrator (often the company sponsoring the plan or a committee of employees of the sponsor) of participant-directed individual account plans such as 401(k) plans.

What must be disclosed? The regulation requires disclosure of two types of information: plan-related information and investment-related information.

Plan-related information. The regulation requires disclosure of general plan information such as how to provide investment instructions, any restrictions on investment instructions, the investment alternatives available under the plan and other related information; administrative expense information regarding fees that may be charged to participant accounts that are not reflected in the operating expense of the investments offered under the plan; and individual expense information regarding fees that may be charged to a participant's account on an individual basis. Additionally, the regulation requires quarterly disclosure of actual fees and expenses charged to each participant's account.

Investment-related information. The regulation requires automatic disclosure of the name, performance data (one-, five- and 10-year data), benchmark data (one-, five- and 10-year data), and fee and expense information regarding each investment alternative available under the plan, all in a comparative format (for which the DOL has issued a model chart). Additionally, the regulation requires the plan administrator to make available a website with additional detail regarding each investment alternative, as well as a glossary of investment terms.

Upon request, the plan administrator must provide copies of prospectuses or summary prospectuses (or similar documents for investments not subject to the prospectus requirements), copies of any financial statements or reports regarding investment alternatives if such information is provided to the plan, a statement of the value of a share or unit of an investment alternative and the date of valuation, and a list of the assets of an investment alternative that constitute plan assets under ERISA.

When must the disclosures be made? With the exception of disclosure of actual fees and expenses charged to participant accounts, the preceding information must be disclosed on or before the date on which a participant or beneficiary can first direct his or her investments and annually thereafter. Actual fees and expenses charged to participant accounts must be disclosed quarterly.

The regulation is effective for plan years beginning on or after November 1, 2011 (January 1, 2012 for calendar year plans). A special transition rule applies for the initial disclosures required by the regulation. Initial disclosures of plan and investment-related information must occur no later than the latter of 60 days after the first day of the first plan year beginning on or after November 1, 2011, or 60 days after the effective date of the fiduciary-level fee disclosure rule (currently **May 31, 2012**). The initial quarterly disclosure of fees/expenses actually deducted from participant accounts must occur no later than 45 days after the end of the quarter in which the initial disclosures were required to be made (**for calendar year plans, August 14, 2012**).

Next Steps

Plan sponsors and service providers should begin now to prepare to comply with the regulations.

Plan Sponsors

- Identify arrangements/service providers subject to the service provider disclosure regulation and discuss with each service provider how and when it will satisfy the requirements.
- Monitor changes to the terms of arrangements that may trigger new or additional disclosures.
- Review plan documents, SPDs and trust documents to confirm that the documents are consistent with the disclosures being provided and the expenses being paid by the plan.
- Adopt procedures that ensure compliance with the disclosure requirements and document such compliance.
- Understand obligations to report noncompliance to the DOL.

- Identify the service provider(s) who can and will assist with meeting the participant disclosure obligations, and determine what changes are necessary to the applicable service contract.

Service Providers

- Identify contracts/arrangements with covered retirement plans.
- Communicate with plan sponsors regarding the disclosure requirements and the expenses that will be tracked.
- Develop a procedure for tracking arrangements subject to the disclosure rules and develop a "model" disclosure document that complies with the rules.
- Determine whether services provided to retirement plans include recordkeeping, investment adviser, brokerage or fiduciary services, and be prepared to provide the additional disclosures applicable to these types of services.
- If commissions, soft dollars, finders' fees or Rule 12b-1 fees are shared among affiliates or subcontractors, be sure systems are in place to track these fees and other details, such as the payee and payor of such fees and the services to which they relate.
- Engage plan sponsors regarding participant disclosure requirements. Determine what, if any, services you will be asked to provide to assist plan administrators in meeting the obligations of the regulation.
- Determine what investment-related documents will satisfy additional disclosure requirements (such as prospectuses and summary prospectuses), and, if necessary, prepare summary documents for investments not subject to the prospectus requirements.

For More Information

For more information, please contact any member of the **Employee Benefits & Executive Compensation** group or **Investment Management** group.

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[1] For purposes of the fee disclosure rules under ERISA 408(b)(2), an investment vehicle holds "plan assets" if 25 percent or more of the assets of the investment vehicle are owned by retirement plans. The managers of investment vehicles holding "plan assets" are treated as fiduciaries of the investing plans.