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## The Department of Labor Issues Final Disclosure Rules

The Department of Labor's recent amendments to ERISA disclosure rules will soon impose significantly heightened disclosure requirements on fiduciaries of retirement plans. These new disclosure requirements will dramatically impact both defined contribution plans and defined benefit pension plans.

The compliance dates for ERISA providers and participant disclosures have recently been extended to January 1, and April 1, 2012, respectively. Covered service providers, employers, and fiduciaries of retirement plans should take advantage of this additional time to familiarize themselves with the plan and prepare for the new requirements.

### The Final Rules Protect Both Plan Fiduciaries and Plan Participants

ERISA Section 406(a) prohibits the *direct or indirect* "furnishing of goods, services, or facilities between the plan and a party in interest." However, since the inception of this prohibition, Congress has acknowledged that plans would benefit from allowing parties in interest to provide services and goods to plans, provided that appropriate safeguards are in place. To this end, Congress enacted ERISA Section 408(b).

Section 408(b) provides a statutory exception to section 406(a)'s broad prohibitions. Section 408(b)(2) permits a party in interest to be compensated for providing services to a plan if (1) the services are necessary for the operation of the plan; (2) the services are supplied under a reasonable arrangement; and (3) compensation for the services is reasonable.

Unfortunately, Section 408(b)(2) has been undermined by a lack of clarity concerning what constitutes a "reasonable" arrangement or compensation for services. To remedy this lack of clarity, the amendments to section 408(b)(2) require service providers to make additional

fee disclosures to satisfy the "reasonableness" standard. The heightened disclosure requirements provide a bright-line rule that will allow plan fiduciaries to more easily evaluate whether a given arrangement is reasonable and ensure that no conflicts of interest are present.

### Summary of New Disclosure Requirements

As of April 1, 2012, plan fiduciaries will be required to comply with two new types of disclosure requirements. First, ERISA section 408 will require plan fiduciaries to carefully consider information disclosed by prospective service providers before determining whether the terms of a particular service agreement are reasonable. Second, ERISA section 404 will require plan fiduciaries for individual retirement accounts to disclose information regarding plan fees, expenses, and available investment options to plan participants and beneficiaries.

### Provider-Level Disclosures

Section 408(b)(2) will only apply to *covered service providers*. Covered providers include plan fiduciaries, investment advisors, record-keepers and brokers, and other plan service providers who reasonably expect to receive \$1,000 or more in direct or indirect compensation for their services. Service provider arrangements with individual retirement accounts and welfare plans are currently exempt from 408(b)(2)'s new disclosure requirements.

Section 408(b)(2) requires all covered service providers to make the following written disclosures "reasonably in advance" of the service agreement:

1. *A description of the services to be provided to the plan.* The plan fiduciary is responsible for ensuring that a description of services provides adequate detail to determinate whether the compensation for

those services is reasonable.

2. *A statement that the service provider will be providing services as a fiduciary or registered investment advisor.* This disclosure only applies to those who will or reasonably expect to be providing services as a fiduciary or registered investment advisor. Disclosure as an investment advisor is only required for investment advisors who are registered under the Advisors Act or any state law.
3. *A description of all compensation the service provider reasonably expects to receive.* “Compensation” includes anything of monetary value; however, non-monetary compensation valued at \$250 or less is excluded from 408(b)(2)’s disclosure requirements. Direct compensation, indirect compensation, compensation paid among related parties, compensation for termination of contract or arrangement, and compensation for record keeping services are all subject to 408(b)(2)’s disclosure requirements.
4. *Disclosures regarding record-keeping services.* If the covered plan receives record-keeping services, the covered service provider must disclose all compensation that he or she reasonably expects to receive in connection with those services.
5. *Manner of compensation.* A covered service provider must disclose the manner in which compensation will be received (e.g., whether it will be directly billed, deducted from a covered plan’s investments, etc.).
6. *Investment related disclosures.* Covered service providers must disclose compensation information concerning the investments with respect to which they are a fiduciary or provide recordkeeping or brokerage services pursuant to the contract or arrangement with the covered plan.

In general, failure to make a required disclosure results in a prohibited transaction. However, the amended regulation provides a narrow prohibited transaction exception. This exception applies in circumstances where a responsible plan fiduciary, acting in good faith and with reasonable diligence, fails to make a required disclosure. In such circumstances, the covered service provider must disclose the correct information no later than 30 days from the date when the error or omission is discovered.

## Participant-Level Disclosures

ERISA section 404 has always required that plan fiduciaries act prudently and solely in the interest of the plan’s participants and beneficiaries. However, ERISA’s existing disclosure requirements have not been adequate to ensure that all plan participants have the information needed to make wise investment decisions. Under the current rule, plan participants are often not provided with detailed information about plan fees and expenses. Further, many plan participants are unable to meaningfully compare their plan’s different investment options.

To address these concerns, the Department of Labor has amended regulations under ERISA section 404 to impose significant new disclosure requirements on plan administrators. The amended rule requires both plan- and investment-related disclosures. All disclosures to plan participants must be presented in an easily comprehensible format that enables plan participants to compare available investment alternatives.

Although the new participant-level disclosures will greatly benefit plan participants and beneficiaries, the new rules will also subject plan fiduciaries to increased exposure. Unlike section 404’s existing disclosure requirements—which are merely voluntary—failure to comply with the new rules could result in a breach of fiduciary duty claim under ERISA. Hence, it is crucial that plan fiduciaries familiarize themselves with the new rules before January 1, 2012.

## Plan Fiduciaries Must Act Now

Commentators have opined that the new regulations will result in a more efficient, fair, and transparent market for financial advice. Regardless of their positive impact, the fact remains that ERISA 408(b)(2) and 404a-5 disclosure regulations will impose significant affirmative obligations for fiduciaries of retirement plans.

The compliance dates for ERISA provider and participant fee disclosures are rapidly approaching. Therefore, it is critical that all those who will be affected are ready when the rules take effect.

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