IDC Independent Directors Council
Promoting Excellence in Fund Governance

Service Provider Disclosure: FAQs

Frequently Asked Questions About Service Provider Disclosure

The Employee Retirement Income Security Act of 1974 (ERISA) requires plan fiduciaries to prudently select and monitor service providers and to act solely in the interest of the plan's participants. Additionally, ERISA requires that a service contract or arrangement must be considered "reasonable." The new service provider disclosure regulation (408b-2) adds additional conditions to the meaning of a "reasonable" contract or arrangement. Specifically, the regulation provides that a contract will not be considered "reasonable" under ERISA unless certain information is disclosed by the service provider to the plan fiduciary regarding their services and the compensation they received or are expected to receive.

What is ICI's position on service provider disclosure?

One of ICI's long-standing priorities has been clear, effective disclosure to all investors, including disclosure for retirement plans and their participants. In January 2007, the ICI Board of Governors adopted a Retirement Plan Disclosure Policy Statement in which the

Institute urged the Department of Labor (DOL) to clarify and enhance the requirement for disclosure of fees and expenses associated with 401(k) plans to assist plan sponsors in making meaningful comparisons of products and services providers. Similarly, the Institute supported action by the Department of Labor to require straightforward descriptions of all the investment options available to participants in self-directed plans. To achieve these goals the Institute recommended that the Department of Labor should require (1) clear disclosure to employers that highlights the most pertinent information, including total plan costs; and (2) that participants in all self-directed plans receive simple, straightforward explanations about each of the investment options available to them, including information on fees and expenses.

Accordingly, the Institute strongly supported the Department's participant disclosure regulation (404a-5) and service provider disclosure regulation (408b-2), issued in October 2010 and February 2012, respectively. These regulations cover disclosure of fees and other pertinent information that plan administrators (typically the employer sponsoring the plan) must provide to their plan participants (workers) and information that service providers, such as recordkeepers and investment managers, must provide to their plan-sponsor clients.

What are the recent developments in service provider disclosure?

Employers and workers received in 2012, for the first time, a new, standardized set of disclosures on all investment options in their plans. These new disclosures highlight any plan-level fees and ensure greater uniformity of disclosures from investment type to investment type. In this respect, information that has long been available from mutual funds—for example, the identification of investment objectives, principal strategies and risks, historical performance, and fees—now is required to be provided directly to participants for both mutual fund and non–mutual fund investments. With such uniformity, participants should find it easier to make the comparisons needed to make better-informed investment choices. Employers began receiving detailed disclosures on fees for administration, investment management, and custody in July 2012 and workers began receiving disclosures in August 2012.

Why are the rules changing?

401(k)s are the most popular type of individual account retirement plan and have become the nation's primary private-sector device for retirement savings. Participant direction of investments has become a dominant feature in these plans. As 401(k)s assume increasing importance for future retirees, clear, meaningful disclosure ensures that plan sponsors and plan participants have the information they need to make informed decisions.

When is the new regulation effective?

The regulations became effective July 1, 2012, for new and existing contracts.

Generally, what information must be disclosed?

The regulations require that service providers provide detailed disclosures of certain direct and indirect compensation received by them, their affiliates, and subcontractors. Direct compensation is compensation received directly from the plan. Indirect compensation is compensation received from any other source other than the plan, plan sponsors, covered service provider or its affiliates or subcontractors.

What types of plan service providers are covered by the new regulation?

Service providers of defined contribution retirement plans (such as 401(k) and certain 403(b) plans) and defined benefit pension plans covered by ERISA.

What types of employee benefit plans are subject to the new regulation?

The new regulation is applicable to any employee pension benefit plan, but does not include governmental or church plans, individual retirement accounts (IRAs), SEPS, SAR-SEPS, or SIMPLE IRAs. Additionally, certain 403(b) plans are excluded from the final rule.

Who is considered a "covered" service provider?

For purposes of the new regulation, a "covered" service provider is a person or entity who enters into a contract or arrangement with a plan and reasonably expects to receive $1,000 or more in compensation for providing services to a plan.

The regulation generally applies to five categories of covered service providers:

1. fiduciaries providing services directly to a plan;
2. fiduciaries providing services to an investment contract, product, or entity that holds plan assets and in which a plan has a direct equity investment (such as a collective trust or separate account);
3. investment advisers, registered under federal or state law, providing services directly to a plan;
4. recordkeepers and brokers providing services to a participant-directed individual account plan if one or more investment

alternatives is made available through a platform; and
5. others providing services for “indirect compensation” such as such as accounting, auditing, banking, custodial, investment advisory, investment brokerage, third-party administration, legal, recordkeeping, valuation, and consulting services.

To whom must the service provider make the disclosure?

The service provider must disclose the information to a responsible plan fiduciary—that is, a fiduciary with authority to cause a plan to enter into, extend, or renew the contract or arrangement.

What information must be disclosed relating to the following?

- *Services.* The service provider must provide a description of the services to be provided to the plan pursuant to the contract or arrangement.
- *Fiduciary Status.* The service provider must disclose whether it, an affiliate, or a subcontractor reasonably expects to provide services to the plan as a fiduciary or as an investment adviser registered under federal or state law.
- *Direct Compensation.* Direct compensation means compensation received directly from the plan (and does not include compensation received from the plan sponsor). The service provider must disclose all direct compensation—either in the aggregate or by service—that the service provider, affiliate, or a subcontractor reasonably expects to receive in connection with the covered services.
- *Indirect Compensation.* Indirect compensation is the compensation received from any source other than the plan, the plan sponsor, the service provider, an affiliate, or a subcontractor. The service provider must disclose all indirect compensation that the service provider, an affiliate, or a subcontractor reasonably expects to receive in connection with covered services. The disclosure must include an identification of the services for which the indirect compensation will be received and identification of the payer of the indirect compensation.
- *Compensation Paid Among Related Parties.* The service provider must disclose a description of compensation paid among the covered service provider, an affiliate, or a subcontractor if set on a transaction basis or if charged against the investment and reflected in net value (such as 12b-1 fees), identifying the services, the payer, and the recipient.
- *Termination Compensation.* The service provider must disclose a description of compensation reasonably expected to be received in connection with termination of the contract or arrangement, as well as how any prepaid amounts will be calculated and refunded upon the termination.
- *Recordkeeping Compensation.* If recordkeeping services are to be provided to the plan, the service provider must disclose all direct and indirection compensation that the provider, an affiliate, or subcontractor expects to receive in connection with the recordkeeping services. If the recordkeeper expects to provide the services without explicit compensation or the compensation is offset or rebated based on other compensation, the service provider must disclose a reasonable good faith estimate of the cost (including an explanation of the methodology used to arrive at the estimate). “Recordkeeping services” include services related to plan administration and monitoring of plan and participant transactions (e.g., enrollment, payroll deductions and contributions, offering designated investment alternatives and other covered plan investments, loans, withdrawals, and distributions).
- *Manner of Receipt.* For disclosures on compensation among related parties or recordkeeping compensation, the service provider must disclose the manner in which the compensation will be received, such as whether the plan will be billed or the compensation will be deducted directly from the plan’s accounts or investments.

When is disclosure required?

Generally, the service provider must make the disclosures reasonably in advance of the date the arrangement is entered into, extended, or renewed. There are allowances for circumstances in which disclosures become required after the contract begins, or in which the service provider learns of an error in previously disclosed materials. If there is a change in information, the service provider must disclose it as soon as practicable.

How must the disclosures be made? Do the regulations require a specific format?

No. The regulation requires only the written disclosure of the required information and that the disclosures must be made to the responsible plan fiduciary. A description or an estimate of compensation may be expressed as a monetary amount, formula, percentage of the plan’s assets, or a per capita charge for each participant—or, if the compensation cannot reasonably be expressed in these terms, by any other reasonable method. Any description or estimate must contain enough information to permit evaluation of the reasonableness of the compensation.

May a service provider provide the disclosures electronically?

Yes. The service provider may furnish information required by the regulation to plan fiduciaries via electronic media. If the service provider’s disclosure information is on a website, it must be readily accessible to the plan fiduciary, and the plan fiduciary must have clear notification on how to gain access.

Is there a required summary or guide to disclosures under the new regulation?

The regulation does not require that a service provider furnish a guide or similar tool to the disclosures. The DOL did, however, include a sample guide as an appendix to the final regulation and the final regulation reserves a place for the future development of a guide or similar tool.

What happens if a service provider fails to disclose the required information to a plan fiduciary?

Upon discovery that a service provider has failed to disclose the required information, a plan fiduciary must request in writing that the service provider provide the required information. If the service provider does not provide the required information within 90 days of the written request, the plan fiduciary must inform the Department of Labor of the failure. The DOL has implemented an online reporting mechanism for such disclosure failures.

What is the purpose behind the prohibited transaction exemption issued concurrent with the new regulation?

Under ERISA, service providers are "parties in interest" to a plan, and their contracts or arrangements with the plan must be "reasonable." Because the final rule expands the definition of "reasonable" to require the disclosures, the failure by the service provider to provide the disclosures would render the contract or arrangement "unreasonable" and would therefore trigger ERISA's prohibited transaction provisions. As such, the final regulation includes a prohibited transaction exemption for plan fiduciaries. If the fiduciary "reasonably believed" that the disclosures were made, and upon discovery of a disclosure failure complies with the procedure discussed above (regarding notice to the service provider upon the failure to provide the disclosures and notice to the Department of Labor), the fiduciary will be not be liable for a prohibited transaction as a result of the disclosure failure.

Where can I get additional information?

- The Final Service Provider Disclosure Rule
- DOL Fact Sheet on the Service Provider Regulations
- FAQs About Mutual Fund Fee Disclosure
- Sample Glossary of Investment-Related Terms for Disclosures to Retirement Plan ParticipantsThis glossary responds to the regulations requiring plan sponsors to provide participants access to a glossary of investment-related terms.
- DOL Model Comparative Chart
- Department of Labor FAQs

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