SANDRA L. NEGRÓN-MONGE

New Disclosure Requirements for Service Providers and Participant-Directed Defined Contribution Retirement Plans

The Department of Labor (DOL) has undertaken a series of regulatory initiatives to ensure that retirement plan participants and beneficiaries, as well as fiduciaries, obtain comprehensive information about the services that are provided to participants of benefit plans and the cost of those services. First, the DOL issued final regulations under § 408(b)(2) of the Employee Retirement Income Security Act (ERISA) of 1974, as amended, addressing disclosures that must be furnished by service providers to fiduciaries before they can enter into, extend, or renew arrangements or contracts for services provided to certain pension plans.[1] A second initiative is the approval of final regulations under ERISA, § 404(a) that impose a fiduciary duty on plan administrators of Internal Revenue Code § 401(k) plans and other participant-directed individual account plans to disclose specified plan and investment-related information, including fee and expense information, to participants and beneficiaries who have a right to direct investments under the plan.[2]

Disclosure of Service Providers' Fees Under ERISA § 408(b)(2)

Section 408(b)(2) of ERISA provides an exemption from the prohibited transaction rules for certain contracts and arrangements for services between a plan and a party in interest (for example, a service provider). One of the requirements to meet the exemption is that the service be furnished under a contract or arrangement that is reasonable. The final § 408(b)(2) regulations provide guidance with respect to this requirement and specifically indicate what disclosures service providers must make to a plan fiduciary for a contract or arrangement to be reasonable.

If the disclosure requirements are not satisfied, the payment of the expenses associated with the contract or service arrangement will not be treated as exempt from ERISA's prohibited transaction rule and may be subject to penalties and excise taxes.

As of July 1, 2012, the final rule applies to new and existing contracts or arrangements for services between a "covered plan" and "covered service providers."

Covered Plans and Service Providers

A "covered plan" is an "employee pension benefit plan" or a "pension plan" within the meaning of ERISA, § 3(2)(A). Defined benefit and defined contribution pension plans are generally included in this definition. However, the rule does not apply to church plans that are not subject to ERISA, governmental plans, plans with no employees (such as Keogh plans covering only owners and their spouses), simplified employee plans (SEPs), SIMPLE retirement accounts, individual retirement accounts (IRAs), and certain "frozen" annuity contracts and custodial accounts established under Internal Revenue Code § 403(b). Also not covered by the rule are welfare benefit plans.[3]

A "covered service provider" (CSP) is a service provider that reasonably expects to receive from a covered plan at least $1,000 in direct or indirect compensation, including the following:

- ERISA fiduciary service providers to a covered plan or to an investment contract, product, or entity that holds a "plan asset" vehicle in which such plan invests;
- investment advisers registered under federal or state law;
- record keepers and brokers providing services solely to an individual account plan that permits participants to direct the investment of their accounts, provided that one or more designated investment alternatives (DIAs) will be made available; and
- specialized service providers, such as those providing accounting, auditing, actuarial, appraisal, banking, consulting, custodial, insurance, investment advisory, legal, record keeping, third-party administration, or valuation services for which the CSP, its affiliates, or its subcontractors reasonably expect to receive "indirect compensation" or payments from related parties.

Disclosure Requirements

The covered service provider must disclose the following information to a responsible plan fiduciary:

- a description of the services to be provided in a clear and understandable manner;
- a statement that the CSP, its affiliates, and/or subcontractors will provide or reasonably expect to provide services as a fiduciary or as a registered investment adviser to the plan;
- all compensation[4] to be received by a CSP, its affiliates, and/or subcontractors, including a description of all direct compensation (for example, compensation received directly from the plan) and all indirect

compensation (for example, compensation received from any source other than the plan, plan sponsor, CSP, its affiliates, and/or its subcontractors) expected to be received; to enable a fiduciary to assess potential conflicts of interests, the description of all indirect compensation must also describe the arrangement between the payer and the CSP (or affiliate or subcontractor);
- compensation paid among a CSP, its affiliates, or its subcontractors on a transaction or incentive basis (for example, commissions, soft dollars, or finders' fees) or charged directly against plan investments;
- compensation paid in connection with the termination of the contract or arrangement, as well as an explantion of how any prepaid expenses will be calculated and refunded at termination;
- if record keeping services will be provided, a description of all direct and indirect compensation the CSP reasonably expects to receive in connection for those services; if the services are expected to be provided as a whole or part, without explicit compensation or to be rebated based on other compensation, the CSP must provide a reasonable and good faith estimate of the cost related to the services as well as an explanation of the methodology used to obtain the estimate; and
- a description of the manner in which compensation will be received (for example, by billing the plan or by deducting the amount directly from the plan's account).

In addition, CSPs of fiduciary services to a plan asset vehicle must provide additional investment disclosures if the plan has a direct equity investment. These disclosures must provide information about: (1) any compensation that will be charged directly against an investment and that is not included in the investment's annual operating expenses and (2) the annual operating expenses if the return is not fixed and any ongoing expenses in addition to the annual expenses or, for DIAs, the total annual operating expenses expressed as a percentage and calculated pursuant to the final § 404(a) regulations. CSPs of record keeping or brokerage services to an individual account plan that permits participants to direct investments are required to provide the same disclosures as required by a fiduciary, as described above, if one DIA or more DIAs is made available in connection with those services.

Form and Timing of Disclosure

The information must be furnished in writing to a responsible plan fiduciary for the covered plan. The rule does not require a formal written contract delineating the disclosure obligation. The DOL released a sample guide in the appendix of the regulation that can be used by CSPs to indicate where specified information can be found in existing documents.

The disclosure must be made reasonably in advance of entering into, extending, or renewing a contract or service arrangement. If an investment begins to hold plan assets or becomes an investment alternative, the disclosure must be made as soon as practicable, but not later than 30 days after becoming a plan asset vehicle, or not later than the date an investment alternative was designated by the covered plan.

A CSP must disclose changes to the initial information as soon as practicable, but not later than 60 days from the date on which the CSP is informed of such changes. Disclosure of changes to investment disclosures are to be made at least annually.

Reporting and Disclosure Information

The final regulations require CSPs to furnish any other information relating to the compensation received in connection with the service agreement upon the request of the plan fiduciary or covered plan administrator reasonably in advance of the date upon which such person states that they must comply with ERISA's reporting and disclosure requirements. If the disclosure is precluded because of extraordinary circumstances beyond the CSP's control, then the disclosure must be made as soon as it is practical to do so.

Disclosure Errors

The final regulations allow for timely corrections of an error or omission in required disclosures when a CSP is acting in good faith and with reasonable diligence. Such corrections must be made as soon as practicable, but not later than 30 days after discovery of the error or omission.

Exemption for a Responsible Plan Fiduciary

The final regulations permit a responsible plan fiduciary to avoid engaging in a prohibited transaction when a CSP fails to disclose required information. Specifically, the final class exemption exempts the fiduciary from the restrictions of ERISA § 406(a)(1)(C) and (D), if, among other things, the fiduciary did not know that the CSP failed to comply with the disclosure requirement and "reasonably believed" that such disclosures were made. Upon discovery of a disclosure failure, the fiduciary must take certain specified steps within designated time frames, including notifying the DOL of any disclosure failure that has not been corrected.

Plan and Investment Disclosure Requirements Under ERISA § 404(a)

ERISA § 404(a), sets forth a standard of conduct that a plan fiduciary is obliged to follow. Pursuant to the regulations under this section of the statute, plan administrators have a new fiduciary duty to provide to plan participants certain plan and investment information. The purpose of this fiduciary duty is to ensure that plan participants and beneficiaries have the information they need to make informed decisions about the management of their individual accounts and the

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investment of their retirement savings. The final rule specifies that the duty to disclose rests with the plan administrator (usually the employer's plan sponsor). Failure to provide the required disclosures will constitute a breach of fiduciary duty under ERISA.

The new requirements apply to any participant-directed individual account plan, as defined in § 3(34) of ERISA (such as 401(k) and profit sharing plans), except plans involving individual retirement accounts, individual retirement annuities, or simple retirement accounts.

Plan-Related Disclosures

The plan administrator must provide the following plan-related information:

- circumstances under which participants may give investment instructions;
- available investment alternatives, including brokerage windows;
- designated investment alternatives offered under the plan;
- reference to plan provisions relating to the exercise of voting rights;
- explanation of administrative fees and expenses charged to the plan as a whole (for legal, accounting, or record keeping services, for example), including a description of how such fees and expenses are allocated among accounts; and
- amount of fees and expenses charged to individual accounts (for investment advice or loans, for example).

In addition, each participant and beneficiary must receive a quarterly statement of the actual fees and expenses charged to his or her account during the preceding quarter and a description of the services to which the charges relate.

Investment-Related Disclosures

The plan administrator must provide the following investment-related information to participants:

- the name of each designated investment alternative and the category of investments available under the plan (such as money market fund, balance fund (stock and/or bond), large-cap stock fund, employer stock fund, and employer securities);
- historical performance data for one-, five-, and 10-year periods;
- amount of fees and expenses imposed by the investment alternatives;
- market benchmarks;
- explanation of all shareholder-type fees and a description of any restriction or limitation applicable to the purchase, transfer, or withdrawal of the investment;
- a website that gives detailed information related to each investment alternative, such as investment objectives and strategies, historical performance data, and fees and expenses; and
- amount of fees, expenses, and the total annual operating cost of each investment (as an expense ratio and a dollar amount per a $1,000 investment); and
- a statement indicating that fees and expenses are only one aspect that participants and beneficiaries should consider when selecting an investment.

The investment-related information must be provided in a chart or other format that facilitates comparison. In addition, a glossary of investment terms must be included to help participants understand the investment disclosures.

For calendar year plans, the initial annual disclosures to participants and beneficiaries must be made by Aug. 30, 2012. After that date, participants and beneficiaries must receive the disclosures on or before the date they can first direct investments under the plan and annually thereafter.

The initial quarterly disclosure of fees and expenses charged to individual accounts must be provided by Nov. 14, 2012, and reflect the fees and expenses deducted from a participant's or beneficiary's account during the third calendar quarter of 2012 (July through September). **TFL**

Sandra L. Negrón-Monge is a counsel in the Labor & Employment Law Practice Group at McConnell Valdés LLC in San Juan, P.R., and chair of the firm's Welfare Benefits and ERISA Litigation Practice Team. She provides counseling to employers in all areas of employment and employee benefits law and actively litigates in administrative, local, and federal forums. She is also chair of the Special Committee on Employee Benefits of the FBA Labor and Employment Law Section. She can be reached at sln@mcvpr.com. *© 2012 Sandra L. Negrón-Monge. All rights reserved.*

Endnotes

[1]29 U.S.C. § 1108(b)(2) (2011). *See also Reasonable Contract or Arrangement Under Section 408(b)(2)—Fee Disclosure*, 77 Fed. Reg. 5,632 (Feb. 3, 2012) (to be codified at 29 C.F.R. 2550). The DOL had issued interim regulations on the same topic back in July 2010, which were to become effective on April 1, 2012. The final regulations take the place of the interim regulations and extend the effective date to July 1, 2012.

[2]29 U.S.C. § 1104(a) (2011). *See also* 29 C.F.R. § 2550.404a-5 (2011). On Oct. 20, 2010, the DOL issued the final rule under ERISA § 404(a), which became effective on Dec. 20, 2010. However, the compliance deadline for individual account plans was set for plan

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About 10 years into the business relationship between GE and Fletcher, GE sent Fletcher a letter referring to Fletcher's failure to pay for some of the scrap Pyranol. In response to this letter, Fletcher sent a letter to GE stating that the scrap Pyranol he had been receiving from GE had decreased in quality; Fletcher requested that GE pick up the unused drums of scrap Pyranol from Fletcher's business. This exchange of letters resulted in the end of the relationship between Fletcher and GE. Fletcher did not pay for many of the drums of scrap Pyranol and GE did not pick up the unused material. Years later, the Environmental Protection Agency "found hundreds of drums containing scrap Pyranol and other chemicals at the Fletcher Site." Many of these scrap Pyranol drums had leaked scrap Pyranol into the environment.

The facts in this case showed that GE had decided how much scrap Pyranol to send Fletcher, continued to send it to Fletcher after he had stopped paying, failed to advertise the scrap Pyranol as a useful material to any other company, and looked into other methods of disposal of the scrap Pyranol, such as sending the material to landfills. After analyzing these facts, the Court said that the facts were sufficient to "establish that GE purposefully entered into its arrangement with Fletcher with the desire to be rid of the scrap Pyranol." The Court explained that GE knew Fletcher would dispose of the scrap Pyranol and GE "took the conscious and intentional step of leaving Fletcher to dispose of the materials." In sum, even though GE had sold the scrap Pyranol to Fletcher, it was clear that GE's main goal was to get rid of the scrap Pyranol. Because of this, GE was found to be an arranger for purposes of CERLCA liability.

Conclusions and Implications

Taken together, the cases decided in 2011 through March 2012 show that, after *Burlington Northern*, to be liable as an arranger under the Comprehensive Environmental Response, Compensation, and Liability Act, a company selling a hazardous substance must have the specific intent to get rid of the hazardous substance itself (as opposed to selling a product containing a hazardous substance). It is not enough for a company to sell a material that contains a hazardous substance; the transaction must, at least in part, be undertaken with the goal of getting rid of the hazardous substance. Even though the company must want to rid itself of the hazardous material, the company does not need a specific intent that the hazardous substance be released into the environment in order for that company to be held liable as an arranger. Knowledge that the hazardous substance is, or may be, released into the environment is not enough, by itself, to make the company selling the hazardous material an "arranger" for purposes of CERCLA liability. In sum, to be liable as an arranger, a company needs to have the specific intent of ridding itself of the hazardous substance. **TFL**

Alexandra E. Shea is an associate with Mayer Brown LLP. She focuses on litigation, transactional, and regulatory issues arising in the environmental law field, in addition to her work on toxic tort litigation. *© 2012 Alexandra E. Shea. All rights reserved.*

Endnotes

[1]This is known as the "useful product doctrine" or "useful product defense" and is a defense to arranger liability under CERCLA. *See,* for example, *Alco Pacific Inc.*, 508 F.3d 930, 934 (9th Cir. 2007). "The defense prevents a seller of a useful product from being subject to arranger liability, even when the product itself is a hazardous substance that requires future disposal. In other words, a person may be subject to arranger liability 'only if the material in question constitutes waste rather than a useful product.'" *Team Enterprises LLC v. Western Inv. Real Estate Trust,* 647 F.3d 901 (9th Cir. 2011).

[2]129 S. Ct. 1870 (2009).

[3]42 U.S.C. § 9607(a)(3).

[4]*Burlington Northern*, 129 S. Ct. at 1878 (quoting 42 U.S.C. § 9607(a)(3)).

[5]*Id.* at 1879 (citing *Thomasville & Denton R. Co.*, 142 F.3d 769, 775 (4th Cir. 1998)).

[6]776 F. Supp. 2d. 857 (E.D. Wisc. 2011).

[7]2011 WL 1106228 (D. Conn. Mar. 22, 2011).

[8]647 F.3d 901, 906 (9th Cir. 2011).

[9]670 F.3d 377 (1st Cir. 2012).

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years beginning on or after Nov. 1, 2011. In July 2011, the DOL extended the compliance deadline to plan years beginning on or after April 1, 2012. This deadline was once again extended in February 2012 by the regulations under ERISA § 408(b)(2) so that the first disclosures under the § 404(a) regulations would follow the effective date of the § 408(b)(2) regulations.

[3]According to the preamble of the final regulations, the DOL intends to separately publish proposed disclosure requirements for welfare benefit plans in the future.

[4]Compensation is anything of monetary value (such as money, gifts, awards, and trips) but does not include nonmonetary compensation valued at $250 or less, in the aggregate, during the term of the service agreement.