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UPDATE: SERVICE PROVIDER AND PARTICIPANT FEE DISCLOSURES
DETAILED MEMORANDUM

In January of this year we provided you with a series of articles regarding the changing rules for retirement plan disclosures. These changes included what certain retirement plan service providers must disclose to plan fiduciaries as well as what plan administrators must disclose to participants who are allowed to direct their investments in a retirement plan. These articles are available on our website at tuggleduggins.com. If you are reviewing this article electronically the prior articles can be viewed through these links: Participant Disclosure Regulations"; "The Obligations of Plan Sponsors and Plan Fiduciaries Under The Service Provider Disclosure Regulations"; "Electronic Delivery of Participant Disclosures" Since we published those articles in January there have been several additional developments and changes concerning these disclosure requirements.

I. TIMING OF DISCLOSURES

The most important change is that the deadlines for making the disclosures were extended but are now imminent. The deadline for service provider disclosures is now ***July 1, 2012***.

For calendar year plans that allow participant direction of investments the initial annual disclosures to participants of "plan-level" and "investment-level" information (including associated fees and expenses) was extended to ***August 30, 2012.*** The first quarterly statement must then be furnished no later than ***November 14, 2012***. For non-calendar year plans the annual disclosure to participants is the later of August 30, 2012 or 60 days after the first day of the plan year beginning on or after November 1, 2011. The first quarterly statement is then due 45 days after the end of the third quarter in which annual disclosures are required.

II. WHY THE DISCLOSURES MATTER

If the service provider disclosures are not made by July 1, 2012 then the plan's responsible fiduciary and the service provider will have committed a prohibited transaction under the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code. Also ERISA's general prudence requirement obligates plan fiduciaries to know what they are paying to

service providers in fees and make sure that compensation is reasonable. The service provider disclosures are a tool for plan fiduciaries to meet this fiduciary obligation.

If the participant disclosures are not made then the plan administrator (often the employer sponsoring the plan) will have breached its fiduciary duty under ERISA. Also, unless these disclosures are made plan fiduciaries will not have protection under ERISA §404(c) and could be held responsible for a plan participant's investment choices.

III. THE FINAL REGULATIONS ON SERVICE PROVIDER DISCLOSURES

In February 2012, the United States Department of Labor (DOL) finalized the regulations on service provider disclosures under ERISA. As mentioned in our earlier article the prior regulations were issued as "interim final" regulations. The regulations issued in February 2012 made some modifications to the interim final regulations described in our prior article. The first significant change was the revised effective date for the disclosures as described above. Among the other changes were:

- The new disclosure will not be required of 403(b) annuity contracts and custodial accounts that were frozen before January 1, 2009. In other words, fully vested contracts/accounts with no contributions made to the account after 2008.

- DOL clarified that service provider disclosures could be made electronically including via a secure website, if the website is readably accessible to plan fiduciaries and those fiduciaries have clear notice on how to gain access to the website.

- DOL modified the actions that responsible plan fiduciaries must take if disclosures are not made. The interim final regulations indicated that if disclosures were not provided the responsible fiduciary (after following the various procedures set forth in the regulations) had to make a decision on whether to terminate the service provider. Termination of a service provider that refuses to provide disclosures is no longer optional under the final regulations. DOL indicated that although there is "some flexibility in securing replacement services", the regulations are "not intended to permit fiduciaries to continue contracts or arrangements indefinitely when there has been an unresolved disclosure failure." Further, in order for a plan fiduciary to be relieved of liability for a disclosure failure, DOL refused to set the standard as one of not knowing or having reason to know of a disclosure failure. The standard imposed by DOL is not knowing or having reason to know of the failure ***coupled with*** the requirement that the responsible fiduciary reasonably believed that adequate disclosure had been made. In DOL's view, this standard establishes the duty of plan fiduciaries to compare the disclosures made with the disclosure requirements of the regulation. As mentioned above, the regulations then provide a detailed description of the actions that the responsible plan fiduciary must take once it discovers the disclosure failure.

- DOL stated that the use of compensation estimates is not limited to recordkeeping fees and that all covered service providers can use estimates if they cannot otherwise readily describe their compensation. The covered service provider must, however, explain the methodology and assumptions used to arrive at the estimate. DOL also agreed that the use of "ranges" to disclose compensation would be reasonable in certain circumstances. DOL did caution that more specific compensation disclosures must be provided whenever possible if this can be done without undue burden.

- As described in our prior article, if compensation was received directly from the plan sponsor (typically the employer is the plan sponsor) as opposed to the plan itself disclosure is not required. DOL clarified, however, that if compensation is paid by the plan sponsor and the plan sponsor receives reimbursement from the plan, then disclosure is required (this type of reimbursement arrangement can also be problematic for other reasons).

- DOL did not provide specific instructions with regard to the level of detail on the description of services that must be part of the disclosure other than saying that this description should be "clear and understandable." DOL did state, however, that plan fiduciaries have a duty to carefully review the information they receive from service providers and ask questions if they do not think they have sufficient detail to make an informed decision about services and costs. The regulations also clarified that the covered service provider needs to furnish a description of ***all*** its services (including those performed by affiliates and subcontractors) and not just the services that make the service provider a "covered service provider" under the regulations.

- For covered service providers that receive indirect compensation the final regulation added an additional requirement that a description of the arrangement between the payer of the indirect compensation and the covered service provider be provided. This is meant to alert plan fiduciaries to any potential conflicts of interest.

- A number of changes were made to make it easier for plan administrators to meet the participant disclosure requirements for those plans that have participant directed investments. For example, the disclosure of certain investment related expenses by covered service providers was modified so that they would be readily transferrable to the required participant disclosures. There is also an added requirement that to the extent a covered service provider has any information that the plan administrator must disclose under the participant disclosure regulations that information must be provided by the covered service provider. The regulations provide that among what must be provided by covered service providers (if they have the information) includes the name and type or category of any participant investment alternative; performance data; and benchmarks. (The covered service provider is not responsible for preparing the required investment

glossary; furnishing the internet web site address or preparing any cautionary statements.) DOL emphasized while there are increased disclosure requirements on covered service providers to help plan administrators meet the participant disclosure requirements the obligation to meet the participant disclosure requirements still lies with plan administrators.

- A change was made to make it easier for service providers to meet certain requirements by "passing through" investment material to the responsible plan fiduciary. Previously, the focus was on whether the "pass through information" was regulated by state or federal authorities. Now the focus is not on whether the information is regulated, but whether the entity generating the information that is going to be passed through is regulated under federal or state law and falls under one of the categories enumerated in the regulations (such as banks, insurance companies, registered investment companies). Also the final regulations state that in order to pass through information the covered service provider must furnish the responsible plan fiduciary with a statement that the covered service provider is making no representations as to the completeness or accuracy of the pass through information (DOL states that this can be done, for example, in a service contract and does not have to be done every time information is passed through).

- DOL, at this time, is not mandating any specific format for disclosures allowing covered service providers flexibility in using single or multiple documents. DOL did, however, provide a "guide" in the appendix to the regulations that covered service providers can use. DOL also indicated that it is planning on issuing a proposed rule in the future concerning a required summary or guide.

- There is a general requirement to disclose changes to previously provided information within 60 days of when the covered service provider is informed of the change. DOL received several comments that this would be burdensome with regard to investment information and that plan fiduciaries might be bombarded with frequent notifications about mundane changes. DOL agreed with these comments and modified this requirement to an annual disclosure of any changes to investment disclosures. The 60 day deadline, however, remains for any changes in other disclosures.

- The final regulations changed the timing on when a covered service provider has to respond to a request for additional information requested in writing by a plan fiduciary. The final interim regulations had a 30 day response time. The final regulations deleted this deadline and substituted a more flexible deadline of reasonably in advance of the date upon which such responsible plan fiduciary or covered plan administrator, states that it must comply with the applicable reporting or disclosure requirement. DOL indicates that the requests for additional information typically are linked to the requirement to file a Form 5500 and this change is apparently designed to avoid circumstances where a service

provider would be forced to respond to a plan fiduciary's request for information necessary to complete a Form 5500 well before the service provider even compiles the information for the year.

- The final regulations continued to exclude self-directed brokerage accounts/windows from the definition of "investment alternatives" and so disclosures related to investment alternatives would not apply to service provider disclosures. DOL clarified that other applicable disclosures are still required for brokerage accounts/windows including a description of the services that will be available to participants who elect to take advantage of the brokerage window; any fees or charges that may be paid "directly" from the plan (or from a participant's account) because of the brokerage window; and any compensation that may be received ''indirectly'' or from related parties in connection with the brokerage window. DOL does understand, however, that compensation that is received may depend on the investments selected by participants through the brokerage window and there is flexibility on how this compensation may be disclosed.

IV. DOL's FIELD ASSISTANCE BULLETIN

On May 7, 2012, DOL issued Field Assistance Bulletin 2012-02 (FAB) which contained thirty eight questions and answers regarding participant fee disclosures for plans that allow participants to direct investments. Some of the most significant clarifications regarding these disclosures are as follows:

A. Covered Plans

DOL clarified that if a plan has both participant directed investments and trustee directed investments, the plan is still covered by the regulations and the plan-related disclosures must be provided. The more detailed investment-related disclosures are, however, only required of the participant directed investment alternatives.

DOL also reiterated that the regulation governs ERISA covered 403(b) plans but DOL "will not take enforcement action against any plan administrator who reasonably determines it would be impracticable, or impossible, to obtain the information necessary to meet the disclosure requirements" for certain 403(b) contracts or accounts that were issued before January 1, 2009.

B. Disclosure of Plan-Related Operational/General Information

DOL stated that plan related and investment related disclosures can be provided in a single document or in separate documents. If provided in a single document, information like the name

of a designated investment alternative that is provided in the plan-related general disclosures would not have to be duplicated in the investment related disclosures.

C. Disclosure of Plan-Related Administrative Expenses

Plan related administrative expense information can be expressed in terms of a monetary amount, formula, percentage of assets, or a per capita charge as long as it is written in a manner to be understood by the average plan participant. DOL stated that the actual detail will depend on the specific facts and circumstances of the particular service and expense. The FAB gives some examples of acceptable disclosures where services and/or fees are known, where services and or fees are unknown, but can be projected, and where fees are to be offset by certain revenue sharing.

DOL indicated that if a plan document limited the payment of administrative expenses to forfeitures or payment directly by the plan sponsor and no administrative expenses were charged to participants' accounts then administrative expense disclosure is not required. DOL indicated that this is the case even where fees may be charged to participants accounts under the document but the employer has always paid these expenses directly or through forfeitures and has committed in writing to pay these expenses. Where payment by the plan sponsor is optional and there is no written commitment, it appears that disclosure may still be required.

DOL distinguished between where administrative expenses are paid through revenue sharing exclusively and reduce a designated investment alternative's rate of return and where administrative expenses are paid separately even if it is based on a percentage of assets. In the latter case, these fees must be expressed as an administrative expense and not an investment expense on the quarterly statement and a breakdown must be provided. In the former case, the fees would come under the general explanation regarding revenue sharing contained in the quarterly statement. Further, the revenue sharing explanation regarding a plan's administrative expenses need not breakdown the specific administrative expenses being paid through that revenue sharing. Finally, if all of the plan's administrative expenses are paid through revenue sharing and no expense is allocated separately to participants accounts, DOL stated that a statement regarding revenue sharing ***is*** still required on the quarterly statement.

D. Directed Brokerage Accounts/Windows and Model Portfolios

As to directed brokerage accounts/windows DOL stated that the plan administrator must provide sufficient information so that participants understand how the brokerage window works and *all* participants must receive information about the brokerage window-- not only those who choose to invest through the window. This disclosure would include any fee to open the brokerage window, maintain the window (including inactivity fees or monthly minimums), terminate the window and the amount of any loads if known. DOL recognized that loads and certain other charges can obviously vary depending on what is purchased through the brokerage window. If this is the case, DOL will allow for a general statement that such fees exist and that

they may be charged against the individual account of a participant making sales or purchases through the brokerage window. The statement must provide directions as to how the participant can obtain information about such fees in connection with any particular investment under the brokerage window. Finally, the statement must "… advise participants and beneficiaries to ask the provider of the window, account, or arrangement about any fees, including any undisclosed fees, associated with the purchase or sale of a particular security through a window, account, or arrangement, before purchasing or selling such security." Quarterly disclosure of actual fees and expenses incurred is also required and this disclosure must explain the charge. DOL gives this example "e.g., $19.99 brokerage trades, $25.00 brokerage account minimum balance fee, $13.00 brokerage account wire transfer fee, $44.00 front end sales load."

The FAB states that an "investment platform" containing numerous mutual fund options (more than 25) will not be treated as a separate and distinct "designated investment alternative" requiring disclosures in addition to those plan related disclosures described above as long as two conditions are met. First, there must be at least three other investments that are treated as designated investment alternatives for disclosure purposes and these alternatives meet the broad range of investment standard contained in ERISA §404(c). Second, the FAB provides that plan administrators have a duty to then monitor the investment platform and if at least five participants (or 1% of participants for plans with over 500 participants) elect the same investment through the platform on a date that is not more than 90 days preceding each annual disclosure date the disclosures of those investments selected through the platform must be made as if they were designated investment alternatives. Legally, there is nothing to distinguish the "platform" from a brokerage window and that these rules appear to be equally applicable to brokerage windows. This is the most controversial aspect of the FAB.

Finally, a number of plans take existing designated investment alternatives and then, from those alternatives, create model portfolios that participants can use (sometimes with labels such as "conservative", "moderate", "growth", etc.). DOL clarified that these model portfolios will not be considered designated investment alternatives themselves as long as they are presented as merely a means of allocating account assets among specific disclosed designated investment alternatives. (If, however, the portfolio is "unitized" it would be considered a separate designated investment alternative). The disclosures should explain how the model portfolio functions and how it differs from the plan's other designated investment alternatives.

E. Closed Funds

DOL explained that investment related disclosures must be provided even for investments closed to new money but the plan administrator may choose to provide that information only to those participants or beneficiaries that remain invested in that closed investment alternative.

F. Disclosure of Investment-Related Information--Internet Web Site Address

DOL stated that a plan administrator will not be responsible for the completeness and accuracy of information used to satisfy the regulation's disclosure requirements, including the website address requirement, when the plan administrator reasonably and in good faith relies on information received from or provided by a plan service provider or the issuer of a designated investment alternative. Further, the website's "landing page" does not have to include all of the supplemental investment information required by the regulations but must be sufficiently specific to provide participants with directions on how to access all required information without difficulty. The FAB provides that for designated investment alternatives without a fixed rate of return, the website must provide annual total returns for 1-, 5-, and 10-year periods ending with the most recent calendar quarter. Performance data must be updated quarterly for designated investment alternatives. While there is no regulatory requirement for updating the website with supplemental information, DOL stated that the website should be "accurate and reasonably current". Finally, the website should reflect the date on which it was most recently updated.

G. Disclosure of Investment-Related Information; Comparative Format ("The Chart")

DOL indicated that plan administrators do not have to use a single unitary chart for comparative information. But if multiple charts are used they must be contained in a single mailing or transmission. There is no requirement to furnish an updated chart mid-year if information changes but as mentioned above, website information should be updated. For investments with a variable rate of return the chart should contain information on 1-, 5- and 10-year periods (or for the life of the alternative, if shorter) as of the date of the most recently completed calendar month or quarter. The benchmark information will have to conform to the same periods. To ensure appropriate comparability, the same ending date for a particular period ordinarily would have to be used for all designated investment alternatives under the plan. If a designated investment alternative has been in existence for more than 10 years "since inception" information is not required.

H. Form of Disclosure

The FAB provides that while plan administrators can make the disclosures as stand-alone documents, they also can be part of other documents like an enrollment package, summary plan description or benefit statement.

I. Operating Expenses for "Fund of Funds" and Stable Value Accounts

Some plans offer a "fund of funds" which is a mutual fund that invests in other mutual funds. DOL clarified that the total annual operating expenses should include the total annual operating expenses of a fund of funds itself, as well as the underlying mutual funds.

DOL also provided guidance on disclosure of a stable value fund that purchases an insurance contract designed to smooth the investment's rate of return. The premiums for the insurance contract reduce the investment's rate of return. DOL stated that in this instance since the insurance component is an expense that is paid by reducing the fund's rate of return, it must be included in the total annual operating expense of the stable value investment.

J. Miscellaneous

DOL clarified that the first quarterly statement only has to include information related to fees and expenses deducted for the quarter to which the statement pertains. As to disclosures that were provided earlier than the date of publication of the FAB or were already in process at the time of the FAB, DOL stated that it would "take into account whether covered service providers and plan administrators have acted in good faith based on a reasonable interpretation of the new regulations". If they have, then no enforcement action would be brought with regard to deviation from the FAB as long as the service provider or plan administrator has a plan for complying with the requirements of the FAB in the future.

V. ACTION STEPS FOR EMPLOYERS

If you have not already received service provider disclosures from the investment professional servicing your plan or from your third party administrator or recordkeeper you should contact them to obtain these disclosures. Review those disclosures to make sure that they conform with the required disclosures contained in our original article "The Obligations of Plan Sponsors and Plan Fiduciaries Under The Service Provider Disclosure Regulations" as modified by this article. If disclosures are not provided, establish follow up procedures with the service provider. You should also analyze the compensation determined by the service provider in this disclosure to make sure it is reasonable. This should be an ongoing and documented process.

If you have a plan with participant directed investments, contact your third party administrator to make sure that they are preparing the requisite disclosures to meet the August 30, 2012 deadline (for calendar year plans) as well as the November 14, 2012 quarterly deadline. You also should check any services agreement with that third party administrator to make sure that these required participant disclosures are part of the services they agreed to provide. You need to determine the form for providing the disclosures (electronic or paper). You should review those disclosures to make sure that they are consistent with what needs to be disclosed as described in our prior article "Participant Disclosure Regulations" and as modified and changed by this article.

If you are attempting to provide the participant disclosures yourself then you should contact us or retain a third party administrator for the limited purpose of helping you with those disclosures. Your investment advisor may also be of help. You will not only need to make the plan-level disclosures but also develop the following with regard to designated investment alternatives: the comparative "chart," a website for participants, a glossary, etc.

If you have any questions concerning the participant disclosure regulations or service provider disclosure regulations, please contact Kenneth Johnson at Tuggle Duggins & Meschan, P.A., 100 N. Greene Street, Suite 600, Greensboro, NC 27401, (336) 271-5264.