



AMERICAN BENEFITS COUNCIL

July 15, 2010

PRELIMINARY SUMMARY OF MAJOR CHANGES IN INTERIM FINAL REGULATIONS REGARDING REASONABLE CONTRACT OR ARRANGEMENT UNDER ERISA SECTION 408(B)(2) FEE DISCLOSURE

On July 15, 2010, the Department of Labor's Employee Benefits Security Administration (EBSA) released interim final regulations under Section 408(b)(2) of the Employee Retirement Income Security Act of 1974, as amended (ERISA), requiring that certain service providers to employer-sponsored retirement plans disclose information to assist plan fiduciaries in assessing the reasonableness of contracts or arrangements, including the reasonableness of the service providers' compensation and potential conflicts of interest. The disclosure requirements, which are established as part of a statutory exemption from ERISA's prohibited transaction provisions, are expected to be published in the Federal Register on July 16. Without the statutory exemption, all contracts or arrangements to provide services to retirement plans would be prohibited transactions.

The Bush Administration originally issued [proposed regulations](#) and a [proposed class exemption](#) in December 12, 2007, as part of a series of defined contribution plan fee disclosure guidance. These regulations were expected to be finalized in early 2009, but were delayed indefinitely by the Obama Administration.

The Obama Administration made significant changes to the proposed regulations and therefore issued them as "interim final" to allow for an additional comment period (within 45 days of publication in the Federal Register). Some of the changes suggested by the American Benefits Council are reflected in the interim final regulation, which is effective July 16, 2011. The final rule will apply to pre-existing contracts or arrangements at that time.

The interim final rule reserves a section of the regulation for application of the rules to health and welfare plans. EBSA acknowledges that application of disclosure rules to

health and welfare plans will have sufficient differences and those issues will need to be addressed separately.

One theme that EBSA emphasizes throughout the interim final regulation is that the onus is on the fiduciary to make sure that the arrangement is reasonable. Below is a brief summary of some of the major differences between the proposed rule and the interim final regulations.

Covered Service Providers

The categories of service providers covered by the final rule vary from those described in the proposal. The proposed rule generally included service providers in the following categories:

- (1) fiduciary service providers, whether under ERISA or the Investment Advisers Act of 1940 (“Advisors Act”),
- (2) service providers that will perform banking, consulting, custodial, insurance, investment advisory, investment management, recordkeeping, or third party administration services for the plan, or
- (3) service providers that will receive indirect compensation in connection with providing accounting, actuarial, appraisal, auditing, legal, or valuation services to the plan.

Covered service providers under the final regulations generally include:

- (1) ERISA fiduciaries who provide direct services to the plan,
- (2) ERISA fiduciaries who provide services to investment products that hold plan assets (but only the first level investment and not the underlying investments within the investment product),
- (3) Investment Advisors registered under either the Advisors Act or State law that provide direct services to the plan,
- (4) recordkeepers or brokers that provide services in connection with a platform of investment options offered to plan participants,
- (5) an indirectly compensated group which includes the list of providers in both (2) and (3) of the original proposal but adds a parenthetical that narrows the scope of “consulting” to consulting related to the development or implementation of investment policies or objectives, or the selection or monitoring of service providers or plan investments.

EBSA also makes clear that plan fiduciaries may have to look at fees beyond the first level of an investment product in the plan in order to meet fiduciary obligations. The

indirectly compensated group also includes unregistered Investment Advisors if they expect indirect compensation. Fees for services to Individual Retirement Accounts (IRAs) are not covered by the rule.

Description of Services and Compensation

In an effort to clarify the flexibility of the requirement to disclose services, the interim final rule omits the word “all” from the required description of services. However, in the preamble, EBSA emphasized that the level of detail required to adequately describe the services provided will vary depending on the needs of the responsible plan fiduciary.

The final rule indicates that all direct compensation (received from the plan) must be disclosed and that a service provider generally may disclose the direct compensation as a total for all services (aggregate total for a bundled provider) or itemize the charges EXCEPT that specific disclosure is required for recordkeeping services. In fact, recordkeeping services are subject to extensive new disclosure requirements described in more detail below.

Disclosure of indirect compensation (received from any source other than the plan, plan sponsor, covered service provider, an affiliate or, in some situations, a subcontractor) must include identification of the services provided and the payer of the indirect compensation. The final rule eliminates the special disclosures categorized as conflict of interest disclosures in the proposal and indicates that the level of detail required in the final regulation (services provided, who is paying) should provide plan fiduciaries with the necessary information to determine whether there are potential conflicts of interest. Disclosure of indirect compensation paid between related parties is only required if the compensation is (1) set on a transaction basis, or (2) charged directly against a plan’s investment and reflected in net value.

For purposes of the rule, “designated investment alternative” does not include brokerage windows, self-directed brokerage accounts or similar arrangements that enable participants and beneficiaries to select investments beyond those specifically designated.

Recordkeeping Services

If recordkeeping services are provided to the plan, the service provider must furnish a description of all direct and indirect compensation that the covered service provider, an affiliate, or any subcontractor reasonably expects to receive in connection with the recordkeeping services. When recordkeeping services are provided without explicit compensation for such services, or when the compensation for recordkeeping services is

offset or rebated based on other compensation received by the service provider, an affiliate or subcontractor, the covered service provider must furnish a reasonable and good faith estimate of the cost to the covered plan of the recordkeeping services, explaining the methodology and assumptions used to prepare the estimate and describing in detail the recordkeeping services that will be provided. The estimate must take into account rates the service provider charges to unrelated third parties or the prevailing market rates charged for similar services to similar plans. EBSA included a standard for estimating recordkeeping costs in the regulation (paragraph (c)(1)(iv)(D)(2)).

In fact, the final rule imposes additional obligations on recordkeepers as well as providers of brokerage services and fiduciaries to certain investment vehicles holding plan assets. These entities are required to disclose other compensation information (not just their own compensation) on the investments to which they are a fiduciary or provide recordkeeping or brokerage services. EBSA indicated in the preamble that they have concluded that these service providers, because they have a relationship with both the investment vehicles and the covered plan, are in the best position to provide plan fiduciaries with the information they need.

Disclosure Timing

The regulations generally provide that the automatically disclosed information must be provided to plan fiduciaries prior to entering into the contract or arrangement and within 60 days of any change in the information previously provided. This is a change from the proposed regulations that would have required additional disclosure within 30 days of a “material” change. EBSA provides more time but eliminates the “material” qualifier. The disclosure must be written but is no longer required to be part of the contract or other arrangement. Presumably this information must be provided prior to the effective date (July 16, 2011) since the regulation states service providers must be in compliance with the regulations as of the effective date even with regard to pre-existing contracts.

Service providers also must provide any information requested by the plan fiduciaries that is required to comply with reporting and disclosure obligations under ERISA within 30 days of the request (the 30-day time limit was added in the final rule). EBSA rejected requests from some organizations that filed comment letters asking that they add the word “reasonable” so that service providers only need to respond to plan fiduciaries’ reasonable requests. EBSA explained that abusive requests should be limited because of the language that the information requested must be “required” to comply with reporting and disclosure obligations.

Relief for Errors

The interim final rule does provide some new relief for errors – specifically for information passed along by recordkeepers, etc. if certain conditions are met, and for any service provider acting in good faith with reasonable diligence who makes an error or omission if it is disclosed as soon as practicable (but no later than 30 days from when the provider knows of the error or omission). However, EBSA did not extend the prohibited transaction exemption relief to covered service providers in the same way that the final “class exemption” covers responsible plan fiduciaries who attempt to address a service provider’s disclosure failure (see discussion below under Bad Actor Reports).

Deminimis Exceptions

The interim final rule establishes a \$1,000 threshold for service providers who would otherwise be covered service providers. The service provider will not be subject to the disclosure requirements unless the service provider reasonably expects to receive \$1,000 or more in compensation, direct or indirect, in connection with providing one or more specified services. However, the rule indicates that the compensation of an unaffiliated “subcontractor” must be reported by the covered service provider if the subcontractor reasonably expects to receive \$1,000 or more in compensation for one or more services.

In addition, the interim final rule contains a new de minimis exception for non-monetary compensation of \$250 or less, in the aggregate, during the term of the contract or arrangement. EBSA explained that it added this provision in response to suggestions concerning the cost and burden of tracking insignificant non-monetary gifts.

Bad Actor Reports

The proposed class exemption, which was incorporated into the interim final rule, provides for limited prohibited transaction relief for plan fiduciaries who unknowingly failed to receive all of the required disclosure information if certain conditions are met. To obtain the relief, the regulation requires that the responsible plan fiduciary (1) did not know that the covered service provider failed or would fail to make the required disclosure and reasonably believed that the covered service provider disclosed the information required by the final rule, and (2) upon discovering the failure, requested in writing that the covered service provider furnish the information. If the covered service provider refuses to provide the requested information or fails to comply with the written request within 90 days, the responsible plan fiduciary must file a detailed notice (within 30 days of the 90 days or the refusal, if earlier) with the Department of Labor which identifies, among other things, the service provider who failed to provide the information. A sample notice will be available on EBSA’s website.