

408(b)(2) Defined Contribution and Defined Benefit Plan Fee Regulations

Benefits Briefing

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Overview

- Introduction
- What is a “408(b)(2)” disclosure?
- Which types of plans must receive this disclosure?
- Which service providers must provide the disclosure?
- What should be in the disclosure?
- When should the disclosure be provided? What if something changes?
- How should a plan fiduciary react to the disclosure?



Introduction

- The Problem
 - **Impact of fees on retirement savings**
 - **Ensuring plan sponsor oversight**
 - **Complexity of compensation**
 - **Insufficient access to information**
- The Response
 - **Schedule C Form 5500**
 - **Participant-level Disclosure Regulation (2550.404a-5)**
 - **Service Provider –Plan Sponsor Disclosure Regulation (2550.408b-2)**



Introduction

- The Parties
 - **Plan Sponsor duties 404(a) / 408(b)(2)**
 - **Service Provider duties 408(b)(2)**
- The Risks
 - **Excise taxes**
 - **Reputational**
 - **Investigations / litigation**



History of the 408(b)(2) Regulation

- Proposed December 2007 (Council files comment letter)
- Hearing held March 2008 (Council testifies)
- DOL published “interim” final rule July 2010 (Council files comment letter)
- Final rule published February 2012



Why is this called a “408(b)(2) disclosure”?

- ERISA section 406 contains a broad prohibition on any “party in interest,” including investment advisers, fiduciaries and other service providers, entering into a transaction with a plan.
 - **Absent an exception, you can’t get paid for providing advisory services to an ERISA plan!**
- ERISA section 408(b)(2) provides an exception for “reasonable arrangements” for necessary services; no more than “reasonable compensation” may be paid.
- The “408(b)(2)” regulation says that a service arrangement is not “reasonable” unless specific disclosures are made to the hiring fiduciary.



Covered Plans and Clients

- Rule applies to all ERISA-governed retirement plans
 - **Defined benefit pension plans**
 - **Defined contribution/401(k) plans**
- Which plans are not covered?
 - **Welfare plans (subject of separate rulemaking)**
 - **IRAs (including SEPs and SIMPLEs)**
 - **Governmental plans**
 - **Church plans**
 - **“Keogh” plans covering only the business owner (and spouse)**
 - **Nonqualified executive compensation plans**
 - **Non-ERISA 403(b) contracts and certain pre-2009 frozen 403(b) contracts**



Covered Service Providers

- Covered Category 1: Fiduciary/RIA services
 - a) **Services provided directly to the plan as an ERISA fiduciary**
 - b) **Services as a fiduciary to a separate account, collective trust, or other investment contract or product that (a) holds “plan assets” and (b) in which the plan has a “direct equity investment.”**
 - c) **Services provided directly to the plan as an investment adviser registered under Advisers Act or state law.**
- Unless (b) applies, services provided to an investment contract or arrangement in which a plan invests (including an investment that holds plan assets) are excluded.



Covered Service Providers

- Covered Category 2: Recordkeeping and brokerage for defined contribution plans that allow participant direction
 - **Applies if you make available “platform” of investments in connection with recordkeeping or brokerage services**
 - **Recordkeeping broadly defined, including**
 - Services related to plan administration
 - Monitoring of plan and participant accounts and transactions
 - Maintaining records of participant accounts
 - Sending participant statements
 - Processing loans, distributions, and withdrawals
 - **This category has special disclosure obligations**



Covered Service Providers

- Covered Category 3: Other service providers but only if they expect to receive **indirect compensation**:

Accounting	Auditing	Appraisal / Valuation	Banking
Consulting (non-fiduciary)	Custodial	Insurance	Investment advisory to plan
Investment advisory to participants	Legal	Recordkeeping / TPA	Brokerage

- Remember: Services provided to an investment contract or arrangement in which a plan invests, except “plan asset” vehicles in which the plan has a direct investment are excluded.



Applying the Rules

- Affiliates and subcontractors of a covered service provider do not need to separately disclose
- Parties in a “bundled” arrangement can agree amongst themselves who will be the covered service provider.
- Disclosure goes to the “responsible plan fiduciary”—fiduciary with authority to enter into the arrangement



Required Disclosure

- Status as a fiduciary or registered investment adviser
- Direct compensation expected to be earned (i.e. paid from the plan or participant accounts)
- Indirect compensation expected to be received from a source other than the plan, plan sponsor, affiliate or subcontractor
 - **NEW: A description of the arrangement**
- Incentive compensation to be paid among affiliates and subcontractors (e.g., commissions, soft dollars, 12b-1)
- Charges for termination of contract
- Reasonable estimate of recordkeeping costs
- Manner of receipt of compensation



Required Disclosure

- Indirect Compensation – Special Focus
 - **For recordkeepers and brokers: describing payments from investments on platform (12b-1, sub-TA, revenue sharing)**
 - **“Soft dollar” research**
 - **Gifts and entertainment**
 - **Conference exhibitors and sponsors**
- Direct Compensation – Payments from Plan Sponsor
 - **Focus on payments usually paid by plan sponsor but *could* be paid by plan**



Required Disclosure

Plan Investments

- Fiduciary managers of plan asset investments and recordkeepers/brokers offering an investment platform must provide additional investment information
- Description of compensation to be charged directly against the investment (commission, sales charges, redemption fees)
- Annual expense ratio
- NEW: For participant directed plans, any information in the control of, or reasonably available to, service provider that plan needs to complete participant disclosure.



Required Disclosure

- Compensation can be disclosed in dollars, formulas, or other reasonable method. Estimates can be used with explanation of the assumptions.
- No disclosure required unless \$1,000 or more in compensation expected
- DOL considering adding “summary” or “guide”.



Timing

- Initial disclosures for existing relationships due July 1, 2012.
 - **Moved back participant disclosure deadline to August 30**
 - **First quarterly statement to participants reflecting participant disclosure rules due November 14.**
- For new contracts or arrangements, reasonably in advance of entering into contract or arrangement PLUS in advance of contract renewal or extension
- If any information changes, new disclosure required within 60 days from being informed of the change
- Investment related disclosures (i.e. expense ratios) need only be updated annually
- Errors in disclosure can be fixed by service provider, but only within 30 days of becoming aware of the error.



Applying the Rules to DB Plans

- Primary covered service provider will be investment manager
 - **Primary fee disclosure will be investment management fee, plus any indirect compensation (soft dollars, gifts and entertainment)**
 - **Form ADV plus investment management agreement may contain most information**
 - **Depending on arrangement, subadviser likely considered subcontractor**
- Other common service providers like brokers, non-fiduciary consultants, actuaries, attorneys subject to the rule only if receiving indirect compensation



Consequences of Failure to Comply

- Prohibited Transaction Results
 - **Service provider incurs 15% excise tax due to IRS (increasing to 100% if discovered on audit). Due every year until issue corrected.**
- Class Exemption for Responsible Plan Fiduciaries
 - **Plan fiduciary must request disclosure, and if not provided in 90 days, must report adviser to DOL.**
 - **Then must terminate future services.**
 - **Most questions and errors can probably be easily addressed through a dialogue with service provider.**



Reviewing the Disclosure

- Basic fiduciary responsibility has not been changed by this regulation.
 - **Act prudently in hiring and monitoring service providers**
 - **Ensure plan assets are used for exclusive purpose of paying benefits and defraying “reasonable” expenses**
 - **Ensure services are necessary and that no more than reasonable compensation is paid to service provider**
- Review 408(b)(2) disclosure and make sure you understand it.
 - **Don't be afraid to ask questions**
- Periodic and documented review of service provider performance and fees.



Questions?

