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TCRS 2012-01: Final Regulations for ERISA §408(b)(2) Service Provider Fee Disclosures Issued.

On February 3, 2012, the Department of Labor ("DOL") issued final regulations concerning the disclosure requirements for services performed and fees charged by covered service providers to retirement plans (commonly referred to as the "408(b)(2) regulations"). The final 408(b)(2) regulations made changes to the "interim final" regulations published on July 16, 2010 (see TCRS 2010-05). Noted below are some of the more significant changes made, as well as the clarification of several issues.

Background

The 408(b)(2) regulations require covered service providers to disclose to plan fiduciaries (i) a description of the services provided to the plan, and (ii) the compensation the plan would pay for such services during the term of the service arrangement.

The disclosure information is necessary for plan fiduciaries to assess the reasonableness of compensation paid for the services, and to identify any conflicts of interest. Complying with the 408(b)(2) regulations provides an exemption from the prohibited transaction rules under ERISA §406(a)(1)(C), which provides that a service arrangement between a plan and a service provider is generally a prohibited transaction.

The effective date for compliance with the 408(b)(2) regulations also impacts the effective date for compliance with the ERISA §404(a) Participant Fee Disclosure regulations (see TCRS 2011-01 and 2011-02).

Changes and/or Clarifications made in the Final 408(b)(2) Regulations

Listed below are topics about which some of the more significant changes were made or items clarified. For some of the topics, a "snapshot" explanation is provided, followed by a more detailed explanation.

Effective Date: July 1, 2012 (previously April 1, 2012). This also extends the general effective date for compliance with the ERISA §404(a) Participant Fee Disclosure regulations ("404(a) regulations") to August 30, 2012 (previously May 31, 2012). When the DOL published amendments to the interim final 408(b)(2) regulations on July 19, 2011, the DOL tied the applicability date of the 404(a) regulations to the effective date of the 408(b)(2) regulations. See TCRS 2011-02.

Covered Plans

Snapshot: The final regulations exclude certain 403(b) plans from the definition of a "covered plan." In addition, the DOL clarified that two other plan types are not "covered plans."

Detail:

- All or part of a 403(b) plan is excluded to the extent of any "frozen" contracts or accounts to which the plan sponsor has no obligation to make contributions. The frozen contracts or accounts had to have been issued, and all contributions to the contracts or accounts had to have ceased, prior to January 1, 2009; all rights and benefits have to be legally enforceable against the issuing insurer by the owner of the contract or account without any involvement by the plan sponsor; and the owner has to be fully vested in such contract or account.
- The DOL clarified that (i) a health savings account and (ii) a plan providing benefits only to a business owner (and his or her spouse), such as "Keogh" or "HR-10" plans that do not cover any employees, are not "covered plans."

Covered Service Providers

Snapshot: The DOL clarified who is a covered service provider and who must provide disclosures in an arrangement where the service provider outsources some of the services and pays compensation to such other provider(s).

Detail:

- Although a "covered service provider" will be such even if affiliates of the covered service provider or subcontractors (a) provide some or all of the services under the contract or arrangement or (b) receive some or all of the compensation for the services, the affiliates or subcontractors do not, themselves, become "covered service providers" solely as a result of the services they perform.

- In an arrangement where multiple services are provided to a covered plan, only the covered service provider (the party entering into the arrangement with the covered plan) is responsible for making the 408(b)(2) disclosures. The DOL provided an example of a recordkeeper that enters into a contract with a covered plan to provide recordkeeping services. The recordkeeper, in turn, outsources some of the recordkeeping services, and pays transaction-based compensation, to a third-party administrator. Since the recordkeeper is the only party entering into the arrangement with the plan, the recordkeeper is the covered service provider (not the third-party administrator), and as such, is the party responsible for making the 408(b)(2) disclosures.

Initial Disclosure Requirements: The final regulations require a covered service provider to describe all services provided to the covered plan under the contract or arrangement, which includes services to be performed by a covered service provider's affiliate or by a subcontractor.

Compensation

Snapshot: The DOL clarified the definition of "direct" compensation and also how compensation, in general, may be described. In addition, the final regulations included new disclosure requirements relating to indirect compensation.

Detail:

- "Direct" compensation includes (i) compensation initially paid by the plan sponsor, but who is then reimbursed from the plan, and (ii) compensation paid directly from participants' and beneficiaries' accounts.
- When disclosing "Indirect" compensation, the covered service provider must (a) identify the services for which the compensation will be received, (b) identify the payer of the compensation, and (c) describe the arrangement between the payer and the covered service provider, affiliate, or subcontractor, as applicable. For purposes of service arrangements involving securities purchased through brokerage windows, self-directed brokerage accounts, or similar arrangements, the descriptions of indirect compensation may be expressed in general terms, but sufficient for a plan fiduciary to evaluate the reasonableness of the compensation in advance of the arrangement. In the interim final regulations, there was no requirement to describe the arrangement between the payer and the covered service provider, affiliate, or subcontractor.
- The final regulations modified how a description of compensation may be expressed. The definition has been expanded from "compensation" to "compensation or cost." In addition, a description of compensation or cost may be expressed as a monetary amount, formula, percentage of the assets, or a per capita charge for each participant or beneficiary. If the compensation or cost cannot be reasonably expressed in such terms, the provider may use any other reasonable method, including a good faith estimate, where the provider explains the methodology and assumptions used for the estimate.

Investment-related Disclosures

Snapshot: The final regulations add consistency requirements for "designated investment alternative" ("DIA") disclosures, so that the 408(b)(2) disclosures will contain the same information required under the 404(a) regulations. For purposes of "pass-through" relief of disclosures for a DIA, the final regulations focus on the whether the issuer of the DIA is regulated, and not whether the disclosures themselves are regulated (which was the focus of the interim final regulations).

Detail:

- A covered service provider must disclose the total annual operating expenses of a DIA, determined in accordance with the 404(a) regulations. In addition, the provider must disclose any other information or data about the DIA that is required for the covered plan administrator to comply with the 404(a) regulations, where such information is within the control or, or reasonably available to, the provider. "Other information or data" includes the name and type or category of the alternative, performance data, benchmarks, principal strategies, and principal risks. For more information about the 404(a) regulations, see TCRS 2010-07.
- A covered service provider may provide the current disclosure materials of the issuer of a DIA (or replicate information from the disclosures) to comply with the investment disclosure requirements of the final regulations. For these purposes, the issuer must be a non-affiliate of the provider, and (i) a registered investment company, (ii) an insurance company qualified to do business in a State, (iii) an issuer of a publicly-traded security, or (iv) a financial institution supervised by a State or Federal agency. In addition, the provider must act in good faith, must not know that the materials are incomplete or inaccurate, and must state that it makes no representations regarding the completeness or accuracy of the materials. If the issuer of a DIA is an affiliate of the covered service provider, the provider may provide the current disclosure materials of the affiliate (and not have to replicate such), but the covered service provider will be responsible for the content of the affiliate's materials.

Summary/Guide to the Initial Disclosures: In the future, covered service providers may be required to furnish plan fiduciaries a summary or guide, separate from the initial disclosures, identifying certain information, such as the document, section, and page number where descriptions of services and compensation may be found. The final regulations contain an appendix, which is a sample guide. The use of the sample guide is strictly voluntary at this point in time. However, the DOL has indicated that it will issue proposed regulations on this issue in the near future and the sample guide, or something similar, may be required in the future.

Disclosure of Changes to Previously Disclosed Initial Information: The deadline for disclosure of changes to initial information previously disclosed that are investment-related must be made at least annually. In the interim final regulations, the deadline had been within 60 days from the date the covered service provider was informed of the change.

Reporting and Disclosure Information

Snapshot: The final regulations changed the due date by which a covered service provider must provide requested information to a fiduciary or plan administrator to enable such to comply with any reporting and disclosure requirement (e.g. Form 5500 and any related schedules).

Detail: Upon receipt of a written request from a plan fiduciary or covered plan administrator for compensation information regarding the contract or arrangement, the covered service provider must provide such information reasonably in advance of the date by which the fiduciary or administrator states it must comply with any reporting and disclosure requirements, unless the disclosure is impossible due to extraordinary circumstances beyond the covered service provider's control (in which case the information must be disclosed as soon as practicable). The interim final regulations had required the covered service provider to disclose the information no later than 30 days following receipt of the written request.

Prohibited Transaction Exemption for a Responsible Plan Fiduciary

Snapshot: The final regulations require a fiduciary to determine whether or not to terminate a contract or arrangement if a provider fails to provide previously undisclosed information within 90 days after the fiduciary's written request for the information. If the information relates to future services, the fiduciary must terminate the contract or arrangement.

Detail: If a provider does not provide information within 90 days following a responsible plan fiduciary's written request for such information which a provider initially failed to disclose, the fiduciary must determine whether or not to terminate the contract or arrangement. In making its determination, the fiduciary must be consistent with its duty of prudence under ERISA §404, considering factors such as the nature of the failure and the availability and costs of a replacement service provider. However, if the requested information relates to future services (service performed after the end of the 90 days following the written request), the fiduciary shall terminate the contract or arrangement as quickly as possible, consistent with its duty of prudence. A "responsible plan fiduciary" is a fiduciary with the authority to cause the covered plan to enter into, extend, or, renew the contract or arrangement.

*This Summary is designed to provide an overview of the DOL's Final Regulations under ERISA §408(b)(2), and is not intended to be comprehensive. The Transamerica Center for Retirement Studies® ("The Center") is a non-profit corporation and private foundation. The Center may be funded by contributions from Transamerica Life Insurance Company and its affiliates or other unaffiliated third-parties. For more information about The Center, please refer to **www.transamericacenter.org**. The Center and its representatives cannot give ERISA, tax or legal advice. This material is provided for informational purposes only and should not be construed as ERISA, tax or legal advice. Interested parties must consult and rely solely upon their own independent advisors regarding their particular situation and the concepts presented here. Although care has been taken in preparing this material and presenting it accurately, The Center disclaims any express or implied warranty as to the accuracy of any material contained herein and any liability with respect to it.*