INTERIM FINAL 408(b)(2) REGULATIONS

July 2010

by: Marcia S. Wagner, Esq.
The Wagner Law Group
A Professional Corporation
99 Summer Street, 13th Floor
Boston, MA 02110
Tel: (617) 357-5200
Fax: (617) 357-5250
www.erisa-lawyers.com

TABLE OF CONTENTS

Page

INTERIM FINAL 408(b)(2) REGULATIONS

I. Statute and Prior Regulations

ERISA §408(b)(2) provides relief from ERISA's prohibited transaction rules for service between a plan and a party in interest (e.g., a plan service provider) if the contract or arrangement is reasonable, the services are necessary for the establishment or operation of the plan, and no more than reasonable compensation is paid for the services. The prior regulations said little as to when a service provider contract or arrangement was reasonable.

II. Proposed Regulations

In December 2007, the U.S. Department of Labor ("DOL") proposed amending its regulations to provide that certain service provider contracts would be reasonable only if the covered service provider discloses to a responsible plan fiduciary specified information about the services to be performed, the compensation to be received and potential conflicts of interest of the service provider. The intent of the proposal was to enable plan fiduciaries

to assess the reasonableness of compensation paid for plan services.

III. Interim Final Regulations

On July 15, 2010, the DOL released a revised version of the fee disclosure regulations with an effective date of July 16, 2011. Thus, the final regulations will apply to existing services arrangements as of July 16, 2011 as well as to new arrangements entered into on or after that date. The one-year lead time is intended to accommodate the costs and burden of transition to the new disclosure regime. However, because the regulations are interim as well as final, new requirements may be added before the effective date. It is not clear whether any additional changes will have an extended effective date for compliance.

IV. Covered Plans

Under the proposed regulations, all employee benefit plans subject to Title I of ERISA were subject to the regulation's disclosure requirements. The final regulations retrench by defining a covered plan to mean an employee pension plan. Excluded from this definition and, therefore, not affected by the disclosure requirements of the final regulation are:

A. Welfare plans - because of significant differences between service and compensation arrangements of welfare plans and pension plans, the DOL intends to develop separate and more specifically tailored disclosure requirements for welfare plans,

B. IRAs,

C. Simplified employee pensions, and

D. Simple retirement accounts.

V. Covered Service Providers. The final rule is limited to service providers that reasonably expect to receive $1,000 or more in compensation (direct or indirect) from providing plan services that fall under one of the following categories:

A. Services as a fiduciary under ERISA or as a registered investment adviser. Such services include:

1. Provider of Fiduciary Services. Services provided directly to a covered plan in the capacity of an ERISA fiduciary.

2. Investment Product Fiduciary. Services provided as a fiduciary to an investment contract, product or entity that holds plan assets. To be included in this new category, the plan must have a direct equity investment in the contract, product or entity. Fiduciary services provided to underlying investments (i.e., to second tier investment vehicles) are not taken into account.

a. Mutual funds are not considered to hold plan assets and, therefore, fund investment advisers are excluded from the definition of a covered service provider. Accordingly, mutual funds are not subject to the general disclosure obligation.

b. Insurance products providing a fixed rate of return are generally considered not to hold plan assets. Thus, products, such as GICs, general account investments and deferred fixed annuities will not result in the insurer becoming a covered service provider. However, a variable annuity based on a separate account that may be treated as a plan asset could give rise to compensation subject to disclosure.

c. Fiduciaries to plan asset vehicles, such as collective trusts, hedge funds and private equity funds are potentially subject to the fee disclosure rules.

3. Registered Investment Adviser. Services provided directly to the covered plan as an investment adviser registered under either the Investment Advisers Act of 1940 or state law.

B. Recordkeeping or brokerage services provided to individual account plans that permit participants to direct the investment of their accounts. This category assumes that one or more designated investment alternatives have been made available through an investment platform. As discussed in items VI.D and E, the final regulations expand the disclosure obligation of such recordkeepers and brokers to compensation information regarding each designated investment alternative.

C. Services within a broad list of categories that are reasonably expected to be paid for by indirect compensation or compensation paid among related parties. Service categories include investment consulting, accounting, auditing, actuarial, appraisal, development of investment policies, third party administration, legal, recordkeeping and valuation services.

VI. Required Disclosure

A. General. A covered service provider must disclose in writing to the plan sponsor or similar plan fiduciary all services to be provided to the plan, not including nonfiduciary services. Service providers must also disclose whether they will provide any services to the plan as a fiduciary either within the meaning of ERISA §3 (21) or under the Investment Advisers Act of 1940.

1. Formal Contract No Longer Required. Unlike the proposed regulations, the final regulation does not require a formal written contract delineating the disclosure obligations.

2. Disclosure of Conflicts No Longer Required. In addition, the final rule eliminates required disclosure of conflicts of interest on the part of service providers. The reasoning for this change is that the expanded disclosure of compensation arrangements with parties other than the plan will be a better tool to assess a service arrangement's reasonableness, as well as potential conflicts of interest.

B. Distinction Based on Direct or Indirect Compensation. Different rules apply to the receipt of direct and indirect compensation, with the latter thought more likely to implicate conflicts of interest.

1. Direct compensation is defined as compensation received from the plan.

2. Indirect compensation is defined as compensation received from a source other than the plan, the plan sponsor, the covered service provider or an affiliate or subcontractor in connection with the services arrangement. For example, indirect compensation generally includes fees received from an investment fund, such as 12b-1 fees, or from another service provider, such as a finder's fee.

3. Non-monetary compensation valued at $250 or less, in the aggregate, during the term of the contract, is disregarded.

C. Disclosure of Compensation. Covered service providers are required to disclose all direct and indirect compensation that the service provider, an affiliate or a subcontractor expects to receive from the plan. In the case of indirect compensation, the service provider must identify the services for which the indirect compensation will be received as well as the payer of the indirect compensation.

1. Format. Compensation may be expressed as a dollar amount, formula,

percentage of covered plan assets, a per capita charge, or by any other reasonable method that allows a plan fiduciary to evaluate the reasonableness of the compensation.

2. Manner of Receipt. Disclosure must include a description of the manner in which the compensation will be received, such as whether it will be billed or deducted directly from participants' accounts.

3. Transaction-Based Fees Received by Affiliates or Subcontractors. Compensation set on a transaction basis (e.g., commissions or soft dollars) or charged directly against the plan's investment (e.g., 12b-1 fees) and paid among the covered service provider, an affiliate or a subcontractor must be separately disclosed. The services for which the compensation is to be paid, the recipient and the payer must be identified. Other types of compensation do not require separate disclosure.

4. Bundled Services. Except for the special rules discussed below, there is no requirement to unbundle service pricing.

D. Special Rules for Recordkeepers. A person who provides recordkeeping services must provide a description of the direct and indirect compensation that the service provider (and its affiliates and subcontractors) expects to receive for recordkeeping services.

1. If there is no explicit fee for recordkeeping services, a reasonable, good faith estimate of the cost to the plan of such services must be provided. The estimate may take into account the rate that the service provider would charge to a third party or prevailing market rates for similar services.

2. Disclosing a de minimis amount of compensation for recordkeeping when the amount has no relationship to cost will not be regarded as reasonable.

E. Special Rule for Platform Providers. Recordkeepers and brokers that make designated investment alternatives available must provide basic fee information for each such alternative for which recordkeeping or brokerage services are provided. This information is in addition to information regarding the recordkeeper's or broker's own compensation. The information to be provided includes the expense ratio, ongoing expenses (e.g., wrap fees), as well as transaction fees (e.g. sales charges, redemption fees and surrender charges) that may be charged directly against the amount invested.

1. Pass-Through of Information on Investment Products. A recordkeeper or broker may satisfy its disclosure obligations for unaffiliated mutual funds by passing through the fund prospectus without having the duty to review its accuracy, provided that the disclosure material is regulated by a state or federal agency.

2. Responsibility of Other Service Providers. If there is no recordkeeper or broker to provide the required information as to the fees associated with a designated investment alternative that holds plan assets, such responsibility passes to the fiduciary of the investment contract, product or entity.

3. Exclusion for Brokerage Windows. Open brokerage windows are not subject to the disclosure requirements for platform providers.

VII. Timing of Disclosures Disclosure of information regarding compensation or fees must be made reasonably in advance of entering into, renewing or extending the contract for services. All of the required disclosures need not be contained in the same document and may be provided in electronic format.

1. During the term of the contract, any change to the previously furnished information must be disclosed within 60 days (expanded from 30 days under the proposed regulations) of the service provider's becoming informed of the change.

2. In contrast to the proposed regulation, the final rule provides that a service contract will not fail to be reasonable (i.e., there will not be a prohibited transaction) solely because the service provider makes an error, provided that the service provider has acted in good faith and with reasonable diligence. Errors or omissions must be disclosed within 30 days of the service provider's acquiring knowledge of the error or omission.

3. When an investment contract, product or entity is initially determined not to hold plan assets but this fact changes, if the covered plan's investment continues, disclosures are required as soon as practicable, but not later than 30 days from the date on which the service provider acquires knowledge that the investment vehicle holds plan assets.

VIII. Curing Disclosure Failures: Prohibited Transaction Exemption

A. Relief for Plan Sponsor. As under the proposed 408(b)(2) regulations, the final rule provides that a service provider's failure to comply with the disclosure

obligations results in a prohibited transaction. Because the prohibited transaction could adversely affect the plan sponsor or similar plan fiduciary, the DOL had proposed a separate class exemption that would have provided relief for the plan fiduciary. This exemption is now incorporated into the final regulation. There is no relief for a service provider that fails to comply with the disclosure requirements.

B. Corrective Action. Relief would be provided if the plan sponsor or similar plan fiduciary enters into a service contract under the reasonable belief that the service provider has complied with its disclosure obligations under the final regulations. To qualify for relief, the plan sponsor or similar fiduciary must take corrective steps with the service provider after discovering the disclosure problem by requesting in writing the correct disclosure information. If the service provider fails to comply within 90 days of such request, the plan fiduciary must notify the DOL not later than 30 days following the earlier of the service provider's refusal to furnish the requested information; or the date which is 90 days after the date the written request is made.

C. Termination of Service Contract. As under the proposed regulations, the plan sponsor or similar fiduciary must also determine whether to terminate or continue the service contract by evaluating the nature of the particular disclosure failure and determining the extent of the actions necessary under the facts and circumstances. Factors to consider, among others, include the responsiveness of the service provider in furnishing the missing information, and the availability, qualifications, and costs of potential replacement service providers.

IX. Immediate Impact and Issues

Currently, service providers need not disclose specific types of information to plan sponsors or similar fiduciaries. The final disclosure regulations require service providers to disclose extensive amounts of information, including the identity of third parties from whom a service provider receives fees as a result of providing services to the plan.

While conflict of interest disclosures have been eliminated, required fee disclosure will present significant internal tracking and communication challenges for large/complex companies. The ongoing 60-day disclosure deadline for information changes will result in similar challenges.

The final regulation clarifies that the new rules will apply to contracts in place when the regulation becomes effective on July 16, 2011. Service providers should begin preparing now to meet the new disclosure requirements, but should be prepared for possible changes to the rules due to the interim status of the regulation.