



**THE PLAN SPONSOR COUNCIL OF AMERICA**  
**Serving Retirement Plan Sponsors for More than 60 Years**  
500 Eighth Street, NW, Suite 210, Washington, DC 20004 202.863.7272  
ferrigno@401k.org

Edward Ferrigno  
Vice President, Washington Affairs

## **SUMMARY OF THE DEPARTMENT OF LABOR FINAL RULE UNDER SECTION 408(b)(2) – SERVICE PROVIDER FEE DISCLOSURE**

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The Department of Labor published its final rule on service provider fee disclosures to plan sponsors on February 3, 2012. The rule amends regulation 2550.408b-2 to provide additional disclosure requirements as a condition for a reasonable contract or arrangement. ERISA section 408(b)(2) provides an exemption to the general rules under section 406 that prohibit a plan fiduciary from using plan assets to pay a “party-in-interest” (service provider) if fees are reasonable.

The rule applies to “covered plans” – ERISA pension plans (DB and DC) as defined in section 3(2)(A), but not plans described in section 4(b) (government plans, church plans, workers comp plans, nonresident alien plans, and excess benefit plans). The rule does not apply to IRAs, SEPs, and SIMPLEs. Additionally, 403(b) annuity contracts and custodial accounts issued to a current or former employee before January 1, 2009, for which the employer ceased to have any obligation to make contributions (including employee salary reduction contributions), and, in fact ceased making contributions to the contract or account for periods before January 1, 2009, and for which all of the rights and benefits under the contract or account are legally enforceable against the insurer or custodian by the individual owner of the contract or account without any involvement by the employer, and for which such individual owner is fully vested in the contract or account, are not covered plans under the rule.

The rule is effective on July 1, 2012. It applies to contracts or arrangements between covered plans and covered service providers as of the effective date. Disclosures are required “reasonably in advance” of entering into a contract or arrangement between a covered plan and a covered service provider, and any extension or renewal of such contract or arrangement. For contracts or arrangements entered into prior to the effective date, the information required to be disclosed must be furnished no later than the effective date.

The rule is “independent of the fiduciary obligations under section 404(a) [general fiduciary rules] of the Act.” This means that the plan fiduciary’s requirement to ensure that any fees paid with plan assets are reasonable are not directly mitigated or altered by the disclosure requirements in the new rule. In the preamble to the rule, the DOL notes that while some contracts or arrangement fall outside the rule, “ERISA nonetheless requires such contracts or arrangements to be ‘reasonable’ in order to satisfy the ERISA section 408(b)(2) statutory exemption.”

Summary disclosures – In the interim final rule that preceded this rule, the DOL requested comments on whether or not service providers should be required to offer a “summary road map” of their disclosures. The final rule reserved judgment on this issue. Simultaneously, the DOL announced a new separate rulemaking process to address this issue. Currently, service providers can meet the disclosure requirements by providing documents, from different sources and at different times, that contain required disclosures. These documents may be voluminous in

nature. The final rule includes a voluntary “sample guide to initial disclosures” in which a provider identifies where specific disclosures can be found in a myriad of documents. PSCA believes that the final rule should be amended to require the disclosures to be provided in a single document.

### **COVERED SERVICE PROVIDER**

A “**covered service provider**” is a service provider that enters into a contract or arrangement with the covered plan and reasonably expects \$1,000 or more in compensation, direct or indirect, to be received in connection with providing one or more of the following services, regardless of whether such services will be performed, or such compensation received, by the covered service provider, an affiliate, or a subcontractor:

- *Services as a fiduciary or registered investment adviser*
  - **Services provided directly to the covered plan as a fiduciary** (unless otherwise specified, a “fiduciary” is a fiduciary within the meaning of section 3(21) of ERISA);
  - **Services provided as a fiduciary to an investment contract, product, or entity that holds plan assets (as determined pursuant to sections 3(42) and 401 of the Act and 29 CFR 2510.3-101) and in which the covered plan has a direct equity investment** (a direct equity investment does not include investments made by the investment contract, product, or entity in which the covered plan invests); or
  - **Services provided directly to the covered plan as an investment adviser** registered under either the Investment Advisers Act of 1940 or any State law.
- *Certain recordkeeping or brokerage service.* Recordkeeping services or brokerage services **provided to a covered plan that is an individual account plan**, as defined in section 3(34) of the Act, **and that permits participants or beneficiaries to direct the investment of their accounts**, if one or more **designated investment alternatives** will be made available (*e.g.*, through a platform or similar mechanism) in connection with such recordkeeping services or brokerage services.
- *Other services for indirect compensation* Accounting, auditing, actuarial, appraisal, banking, consulting (*i.e.*, consulting related to the development or implementation of investment policies or objectives, or the selection or monitoring of service providers or plan investments), custodial, insurance, investment advisory (for plan or participants), legal, recordkeeping, securities or other investment brokerage, third party administration, or valuation services provided to the covered plan, for which the covered service provider, an affiliate, or a subcontractor reasonably expects to receive indirect compensation or compensation paid among related parties (as defined in the rule)
- **Limitations** No person or entity is a “covered service provider” solely by providing services as an affiliate or a subcontractor that is performing one or more of the covered services described above under the contract or arrangement with the covered plan; or to an investment contract, product, or entity in which the covered plan invests, regardless of whether or not the investment contract, product, or entity holds assets of the covered plan, other than services provided as a fiduciary to an investment contract, product, or entity that holds plan assets (as determined pursuant to sections 3(42) and 401 of the Act and 29 CFR 2510.3-101) and in which the covered plan has a direct equity investment (a direct equity investment does not include investments made by the investment contract, product, or entity in which the covered plan invests).

### **INITIAL DISCLOSURE REQUIREMENTS**

The covered service provider must disclose the following information to a responsible plan fiduciary, in writing (the disclosures do not have to be incorporated within a formal contract)—

- **A description of the services to be provided** to the covered plan pursuant to the contract or arrangement (but not including non-fiduciary services relating to an investment contract, product, or entity in which the plan invests, regardless of whether or not the investment holds assets of the plan).

- If applicable, a **statement that the covered service provider, an affiliate, or a subcontractor will provide, or reasonably expects to provide, services pursuant to the contract or arrangement directly to the covered plan, or to an investment contract, product or entity that holds plan assets and in which the covered plan has a direct equity investment (not investments made by the contract, product, or entity), as a fiduciary**; within the meeting of Section 3(21), and, if applicable, a statement that the covered service provider, an affiliate, or a subcontractor will provide, or reasonably expects to provide, services pursuant to the contract or arrangement directly to the covered plan **as an investment adviser registered under either the Investment Advisers Act of 1940 or any State law.**
- **A description of all direct compensation**, either in the aggregate or by service, that the covered service provider, an affiliate, or a subcontractor reasonably expects to receive in connection with the services
- **A description of all indirect compensation** that the covered service provider, an affiliate, or a subcontractor reasonably expects to receive in connection with the services, including identification of the services for which the indirect compensation will be received and identification of the payer of the indirect compensation, and a description of the arrangement between the payer and the covered service provider, an affiliate, or a subcontractor.
- **A description of any compensation that will be paid among the covered service provider, an affiliate, or a subcontractor**, in connection with the services **if it is set on a transaction basis** (e.g., commissions, soft dollars, finder's fees or other similar incentive compensation based on business placed or retained) **or is charged directly against the covered plan's investment and reflected in the net value of the investment** (e.g., Rule 12b-1 fees); including identification of the services for which such compensation will be paid and identification of the payers and recipients of such compensation (including the status of a payer or recipient as an affiliate or a subcontractor). Compensation must be disclosed regardless of whether such compensation also is disclosed pursuant to other requirements of the rule. This paragraph shall not apply to compensation received by an employee from his or her employer on account of work performed by the employee.
- **A description of any compensation that the covered service provider, an affiliate, or a subcontractor reasonably expects to receive in connection with termination of the contract or arrangement**, and how any prepaid amounts will be calculated and refunded upon such termination.
- In addition to other compensation disclosure requirements, **if recordkeeping or brokerage services will be provided to the covered plan, the recordkeeper or broker must provide:**
  - A description of all direct and indirect compensation that the covered service provider, an affiliate, or a subcontractor reasonably expects to receive in connection with such recordkeeping services; and
  - If the covered service provider reasonably expects recordkeeping services to be provided, in whole or in part, without explicit compensation for such recordkeeping services, or when compensation for recordkeeping services is offset or rebated based on other compensation received by the covered service provider, an affiliate, or a subcontractor, a reasonable and good faith estimate of the cost to the covered plan of such recordkeeping services, including an explanation of the methodology and assumptions used to prepare the estimate and a detailed explanation of the recordkeeping services that will be provided to the covered plan. The estimate shall take into account, as applicable, the rates that the covered service provider, an affiliate, or a subcontractor would charge to, or be paid by, third parties, or the prevailing market rates charged, for similar recordkeeping services for a similar plan with a similar number of covered participants and beneficiaries.

- **Investment disclosure – fiduciary services.** A covered service provider providing services as a fiduciary to an investment contract, product, or entity that holds plan assets (as determined pursuant to sections 3(42) and 401 of the Act and 29 CFR 2510.3-101) and in which the covered plan has a direct equity investment (a direct equity investment does not include investments made by the investment contract, product, or entity in which the covered plan invests), with respect to each plan investment, must provide the following information, except that the fiduciary services provider does not have to make a disclosure if it is made by covered provider that provides a recordkeeper or brokerage service-:

  - A description of any compensation that will be charged directly against the amount invested in connection with the acquisition, sale, transfer of, or withdrawal from the investment contract, product, or entity (e.g., commissions, sales loads, sales charges, deferred sales charges, redemption fees, surrender charges, exchange fees, account fees, and purchase fees);, unless included in annual operating expenses;
  - A description of the annual operating expenses (e.g., expense ratio) if the return is not fixed and any ongoing expenses in addition to annual operating expenses (e.g., wrap fees, mortality and expense fees), or, for an investment contract, product, or entity that is a designated investment alternative, the total annual operating expenses expressed as a percentage and calculated in accordance with the participant fee disclosure regulations in 29 CFR 2550.404a-5(h)(5); and
  - For an investment contract, product, or entity that is a designated investment alternative, any other information or data about the designated investment alternative that is within the control of, or reasonably available to, the covered service provider and that is required for the covered plan administrator to comply with the participant fee disclosure obligations described in 29 CFR 2550.404a-5(d)(1).
- **Investment disclosure - recordkeepers and brokerage services.** A recordkeeper or brokerage service must make the disclosures described immediately above for fiduciary services providers with respect to each designated investment alternative for which recordkeeping or brokerage services are provided. A covered service provider may comply by providing current disclosure materials of the issuer of the designated investment alternative that include the required disclosures provided that

  - the issuer is not an affiliate,
  - the issuer is a registered investment company, an insurance company qualified to do business in any state, an issuer of a publicly traded security, or an financial institution supervised by a state or federal agency; and
  - the service provider acts in good faith and does not know that the materials are incomplete or inaccurate and furnishes the responsible plan fiduciary with a statement that the covered service provider is making no representations as to the completeness or accuracy of such materials.

In the preamble, the DOL states that service providers may pass through materials of an affiliate, but they are responsible for the content of those materials.

- **Manner of receipt.** The disclosure must include a description of the manner in which compensation will be received, such as whether the covered plan will be billed or the compensation will be deducted directly from the covered plan’s account(s) or investments.

***Timing of initial disclosure requirements and changes in terms.*** A covered service provider must make the required disclosures to the responsible plan fiduciary reasonably in advance of the date the contract or arrangement is entered into, extended, or renewed.

When an investment contract, product, or entity is determined not to hold plan assets upon the covered plan's direct equity investment, but subsequently is determined to hold plan assets while 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 covered service provider knows that such investment contract, product, or entity holds plan assets.

Information about new plan investment options must be provided as soon as practicable, but not later than the date the investment alternative is designated by the covered plan.

A covered service provider must disclose a change in the initial disclosure as soon as practicable, but not later than 60 days from the date on which the covered service provider is informed of such change, unless such disclosure is precluded due to extraordinary circumstances beyond the covered service provider's control, in which case the information must be disclosed as soon as practicable. **However, changes to investment disclosures by fiduciaries, record keepers, or providers of brokerage services must be provided at least annually.**

**Requests for additional information.** Upon written request of the responsible plan fiduciary or covered plan administrator, the covered service provider must furnish any other information relating to the compensation received in connection with the contract or arrangement that is required for the covered plan to comply with the reporting and disclosure requirements of Title I of ERISA and the regulations, forms and schedules issued thereunder. The covered service provider must disclose the information reasonably in advance of the date upon which such responsible plan fiduciary must comply with the applicable reporting or disclosure requirement, unless such disclosure is precluded due to extraordinary circumstances beyond the covered service provider's control, in which case the information must be disclosed as soon as practicable.

**Disclosure error.** No contract or arrangement will fail to be reasonable solely because the covered service provider, acting in good faith and with reasonable diligence, makes an error or omission in disclosing required information, provided that the covered service provider discloses the correct information to the responsible plan fiduciary as soon as practicable, but not later than 30 days from the date on which the covered service provider knows of such error or omission.

## **DEFINITIONS**

**Affiliate** A person's or entity's "affiliate" directly or indirectly (through one or more intermediaries) controls, is controlled by, or is under common control with such person or entity; or is an officer, director, or employee of, or partner in, such person or entity. Unless otherwise specified, an "affiliate" refers to an affiliate of the covered service provider.

**Compensation** Compensation is anything of monetary value (for example, money, gifts, awards, and trips), but does not include non-monetary compensation valued at \$250 or less, in the aggregate, during the term of the contract or arrangement.

**"Direct" compensation** is compensation received directly from the covered plan.

**"Indirect" compensation** is compensation received from any source other than the covered plan, the plan sponsor, the covered service provider, or an affiliate. Compensation from a subcontractor is indirect compensation unless received in connection with covered services performed under the subcontractor's contract or arrangement with a covered plan.

A description of compensation or cost may be expressed as a monetary amount, formula, percentage of the covered plan's assets, or a per capita charge for each participant or beneficiary or, if the compensation or cost cannot reasonably be expressed in such terms, by any other reasonable method. The description may include a reasonable and good faith estimate if the covered service provider cannot otherwise readily describe compensation or cost and the covered service provider explains the methodology and assumptions used to prepare such estimate. Any

description, including any estimate of recordkeeping cost, must contain sufficient information to permit evaluation of the reasonableness of the compensation or cost.

A “**designated investment alternative**” is any investment alternative designated by the covered plan into which participants and beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts. **The term “designated investment alternative” shall not include brokerage windows, self directed brokerage accounts, or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by the covered plan.**

“**Recordkeeping services**” include services related to plan administration and monitoring of plan and participant and beneficiary transactions (e.g., enrollment, payroll deductions and contributions, offering designated investment alternatives and other covered plan investments, loans, withdrawals and distributions); and the maintenance of covered plan and participant and beneficiary accounts, records, and statements.

A “**responsible plan fiduciary**” is a fiduciary with authority to cause the covered plan to enter into, or extend or renew, the contract or arrangement.

A “**subcontractor**” is any person or entity (or an affiliate of such person or entity) that is not an affiliate of the covered service provider and that, pursuant to a contract or arrangement with the covered service provider or an affiliate, reasonably expects to receive \$1,000 or more in compensation for performing services as a covered service provider under a contract or arrangement with a covered plans.

#### **EXEMPTION FOR RESPONSIBLE PLAN FIDUCIARY**

The rule provides an exemption to an otherwise prohibited transaction between a plan fiduciary and a party in interest. Failure to comply with the rule results in the plan fiduciary being a party in a prohibited transaction, and liable for a fiduciary breach. The rule provides specific relief to plan fiduciaries who do not receive the disclosures required under the rule. The plan fiduciary is not liable for any failure by a covered service provider to disclose required information if the fiduciary did not know that the covered service provider failed or would fail to make required disclosures and reasonably believed that the covered service provider disclosed the information required under the rule.

The responsible plan fiduciary, upon discovering that the covered service provider failed to disclose the required information, must request in writing that the covered service provider furnish such information. If the covered service provider fails to comply with such written request within 90 days of the request, the responsible plan fiduciary must notify the Department of Labor of the covered service provider’s failure. The notice shall contain the following information –

- (1) The name of the covered plan;
- (2) The plan number used for the covered plan’s Annual Report;
- (3) The plan sponsor’s name, address, and EIN;
- (4) The name, address, and telephone number of the responsible plan fiduciary;
- (5) The name, address, phone number, and, if known, EIN of the covered service provider;
- (6) A description of the services provided to the covered plan;
- (7) A description of the information that the covered service provider failed to disclose;
- (8) The date on which such information was requested in writing from the covered service provider; and
- (9) A statement as to whether the covered service provider continues to provide services to the plan;

The notice must be filed with the Department not later than 30 days following the earlier of the covered service provider’s refusal to furnish the information requested by the written request or 90 days after the written request is made. The DOL has provided a sample notice.

If the covered service provider fails to comply with the written request for information within 90 days of such request, the responsible plan fiduciary shall determine whether to terminate or continue the contract or arrangement

consistent with its duty of prudence under section 404 of the Act. **If the requested information relates to future services and is not disclosed promptly after the end of the 90-day period, then the responsible plan fiduciary shall terminate the contract or arrangement as expeditiously as possible, consistent with such duty of prudence.**

#### **PREEMPTION OF STATE LAW**

The rule shall not be construed to supersede any provision of State law that governs disclosures by parties that provide the services described in this section, except to the extent that such law prevents the application of a requirement of the rule.

#### **INTERNAL REVENUE CODE**

Section 4975(d)(2) of the Code contains provisions parallel to section 408(b)(2) of the Act. Effective December 31, 1978, section 102 of the Reorganization Plan No. 4 of 1978, 5 U.S.C. App. 214 (2000 ed.), transferred the authority of the Secretary of the Treasury to promulgate regulations of the type published herein to the Secretary of Labor. All references herein to section 408(b)(2) of the Act and the regulations thereunder should be read to include reference to the parallel provisions of section 4975(d)(2) of the Code and regulations thereunder at 26 CFR 54.4975-6.