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DOL Issues Final Regulations Under ERISA Section 408(b)(2)

On February 3, 2012, the U.S. Department of Labor ("DOL") published final regulations (the "Regulation") under Section 408(b)(2) of the Employee Retirement Income Security Act of 1974 ("ERISA") requiring disclosures of fees by certain service providers.

Under Section 408(b)(2) a "Covered Plan" (as described below) may enter into service contracts or arrangements with "covered service providers" to the extent that such contracts or arrangements are reasonable, the services are necessary for the establishment or operation of the plan, and no more than reasonable compensation is paid for such services. The Regulation provides that no otherwise covered arrangement is "reasonable" unless the disclosures required by the Regulation have been satisfied.

Effective Date

Although the effective date for these rules under prior interim regulations was April 1, 2012, under the Regulation, the effective date has been extended until July 1, 2012. Therefore, for arrangements in place on or before July 1, 2012, covered service providers must provide disclosures to Covered Plans prior to that date.

Covered Plans

The Regulation only applies to service providers to "Covered Plans," which in general include pension plans (such as 401(k) plans or profit sharing plans) subject to ERISA. Covered Plans do not include health and welfare benefit plans, individual retirement accounts (or simplified employee pension plans or SIMPLE plans), or certain 403(b) annuity contracts or custodial accounts issued to current or former employees before January 1, 2009.

Service Providers

In general, a service provider is a "covered service provider" to a Covered Plan and is subject to the Regulation if it enters into a contract or arrangement with a Covered Plan and reasonably expects to receive U.S. $1,000 or more in direct or indirect compensation in connection with providing any of the following services:

1. Services as a fiduciary directly to the Covered Plan, services provided as a fiduciary to a "plan assets" contract or vehicle in which the Covered Plan has a direct equity investment or services provided directly to the Covered Plan as a registered investment adviser. For these purposes, a direct equity investment does not include investments made by a plan assets vehicle in which a Covered Plan invests (i.e., no "look through" to a second tier investment vehicle);

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2. Certain plan recordkeeping or brokerage services, including recordkeeping services or brokerage services provided to a participant-directed retirement plan that is an individual account plan (generally a 401(k) plan) and that permits participants to direct the investment of their accounts, if one or more designated investment alternatives will be made available (i.e., through a third-party platform or similar arrangement) in connection with such recordkeeping services or brokerage services;
3. Other services for indirect compensation, including accounting, banking, auditing, actuarial, custodial appraisal, insurance, consulting related to the development or implementation of investment policies or objectives, or the selection or monitoring of service providers or plan investments, investment advisory, legal, recordkeeping, securities or other investment brokerage, third-party administration, or valuation services.

No person will be a "covered service provider" solely by providing services to a plan assets vehicle, other than services as a fiduciary. Unlike the Form 5500 Schedule C reporting requirements, under the Regulation, only services for a "plan asset" vehicle are covered (as described above).

Disclosure Requirements

In general, reasonably in advance of the provision of services (or prior to July 1, 2012 in relation to current arrangements), a covered service provider must disclose to a responsible plan fiduciary in writing: (i) a description of the services to be provided to the Covered Plan; (ii) if applicable, a statement that the covered service provider, an affiliate, or a subcontractor will provide services either (A) directly to the Covered Plan (or to a plan assets vehicle in which the Covered Plan has a direct equity investment) as a fiduciary or (B) directly to the Covered Plan as a registered investment adviser; (iii) a description of the compensation (direct and indirect) that a covered service provider, an affiliate, or a subcontractor reasonably expects to receive in connection with the services (direct compensation is compensation received directly from the Covered Plan, while indirect compensation is compensation received other than from the Covered Plan, the plan sponsor or the covered service provider or its affiliate); (iv) any compensation in connection with termination of the contract or arrangement (and how any prepaid amounts will be calculated and refunded upon such termination); and (v) the manner in which the compensation will be received (such as whether the Covered Plan will be billed directly or the compensation will be deducted directly from the Covered Plan's account(s)).

In addition, each payer of indirect compensation to the service provider and the services for which payment is to be made must be identified, and the arrangement made between the payer and the service provider must be described. Certain other disclosures relating to payments from affiliates or subcontractors are also required, if applicable.

A description of compensation or cost may generally be expressed as a monetary amount, formula, percentage of the Covered Plan's assets or per capita charge for each participant or beneficiary. If the compensation or cost cannot reasonably be expressed in the foregoing manner, such compensation or costs may be expressed by any other reasonable method, and may include a reasonable and good faith estimate if the covered service provider explains the methodology and assumptions used to prepare such estimate.

Recordkeeping Services

A covered service provider of recordkeeping services must separately describe all direct and indirect compensation that the covered service provider, an affiliate, or a subcontractor reasonably expects to receive in connection with such services. If the covered service provider reasonably expects recordkeeping services to be provided, in whole or in part, without explicit compensation (i.e., as part of bundled services) for such recordkeeping services, or if compensation for recordkeeping services is offset or rebated based on other compensation received by the covered service provider, an affiliate, or a subcontractor, then the covered service provider must give a reasonable and good faith estimate of the cost to the Covered Plan of such recordkeeping services, which may be based on prevailing rates in the market or other reasonable estimates.

Special Disclosures for Investment and Administrative Platform Providers for Participant-Directed Plans

Providers of recordkeeping and brokerage services to a participant-directed individual account plan must disclose additional investment-related fee and expense information if the service provider makes available one or more designated investment alternatives. Subject to certain requirements, a service provider may generally satisfy these rules by passing through in good faith to the responsible plan fiduciary copies of any prospectuses and other disclosure materials of an issuer of the designated investment alternative, provided that the issuer is not affiliated with the service provider, and provided further that the issuer is a registered investment company, an insurance company qualified to do business in a state, an issuer of a publicly-traded security, or a financial institution supervised by a state or federal agency.

Fiduciary Services

A covered service provider of fiduciary services to an investment contract, product or a "plan assets" vehicle in which a Covered Plan has a direct equity investment must provide (unless otherwise provided by a service provider of recordkeeping or brokerage services pursuant to the Regulation): (i) a description of any compensation that will be charged directly against an investment (i.e., sales loads, sales charges, deferred sales charges, redemption fees, surrender charges, exchange fees, account fees, and purchase fees) and that is not included in the annual operating expenses of the investment; (ii) a description of (A) the annual operating expenses (i.e., expense ratio) if the investment return is not fixed, (B) any other expenses (i.e., wrap fees, mortality and expense fees), or (C) for an investment vehicle that is a designated investment alternative for a plan, the total annual operating expenses expressed as a percentage and calculated in accordance with the DOL's participant-level disclosure regulations; and (iii) for an investment vehicle 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 DOL's participant-level disclosure regulations.

Changes to Information

A covered service provider must generally make the required initial disclosures to the responsible plan fiduciary reasonably in advance of the date the contract or arrangement is entered into, and each time that it is extended or renewed. Generally, a change to such information must be disclosed as soon as practicable, but generally no later than 60 days from the date on which the covered service provider is informed of such change. Disclosures for services provided as a fiduciary and changes to investment-related disclosures for recordkeeping and brokerage services must be provided at least annually.

Upon a request in writing, a 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 (for example, Schedule C to the plan's Form 5500). This information must be furnished reasonably in advance of the date upon which the responsible plan fiduciary states that it must comply with the applicable reporting or disclosure requirement.

The information included above is only a brief overview of the Regulation. As with all guidance, the application to any particular service provider or plan will depend upon each parties' particular circumstances.

Please contact your usual Clifford Chance contact or Jeffrey Lieberman (212) 878-8013 or Robert Stone (212) 878-8144 of our Employee Benefits and Executive Compensation Group if you have any questions or would like to discuss these requirements.

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