The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

**MEMO# 25875**

February 7, 2012

# DOL Issues Final 408(b)(2) Regulation on Disclosure of SErvice Provider Compensation and Extends Compliance Date to July 1, 2012 -- Revised Dial-in Instructions

ACTION REQUESTED

[25875]

February 7, 2012

TO: PENSION COMMITTEE No. 6-12
PENSION OPERATIONS ADVISORY COMMITTEE No. 6-12
OPERATIONS COMMITTEE No. 4-12
BANK, TRUST AND RETIREMENT ADVISORY COMMITTEE No. 6-12
BROKER/DEALER ADVISORY COMMITTEE No. 5-12
TRANSFER AGENT ADVISORY COMMITTEE No. 7-12 RE: DOL ISSUES FINAL 408(b)(2) REGULATION ON DISCLOSURE OF SERVICE PROVIDER COMPENSATION AND EXTENDS COMPLIANCE DATE TO JULY 1, 2012 -- REVISED DIAL-IN INSTRUCTIONS

This memo supersedes ICI Memorandum No. 25868 dated February 6, 2012. Revised dial-in instructions are below.

The Institute will hold a conference call to discuss the final rule on Tuesday, February 14, 2012 at 3:30 p.m. ET. If you would like to participate in this call, please respond to Brenda Turner at bturner@ici.org or by phone at 202-326-5820 by close of business on Monday, February 13, 2012. To participate, please dial 1-888-787-0207 and enter passcode 56923.

The Department of Labor issued a final regulation setting out the information that plan service providers must provide to plan fiduciaries in order for a service contract or arrangement to be considered reasonable under ERISA § 408(b)(2) and not result in a prohibited transaction under ERISA. [1] The final rule differs in several respects from the interim final regulation. [2] DOL addressed many, but not all, of the concerns the Institute raised in our comment letters on the interim final regulation [3] and the initial service provider disclosure regulation proposed in December 2007. [4] The Department determined not to add a requirement for a summary or guide to the disclosures or

otherwise mandate a format for a summary or guide, but stated it will separately publish a proposal for a guide at a later date. [5]

## Effective Date

The effective date of the final rule was delayed until July 1, 2012. This delays the compliance date of the participant-level disclosure regulation to August 30, 2012 (60 days after the effective date of the 408(b)(2) regulation). [6]

## Covered Plans and Service Providers

The final rule adds a new exclusion and makes several clarifications to the definition of "covered plan." Certain 403(b) plans are excluded from the final rule. Specifically, the DOL excluded annuity contracts and custodial accounts issued to employees in such plan arrangements before January 1, 2009 where the employer ceased making contributions (including employee salary reduction contributions), where rights or benefits of individual owners of the contracts or accounts are enforceable against the insurer of custodian without employer involvement, and where individual owners are fully vested in the benefits provided under the contract or account.

The final rule also clarifies that health savings accounts, and plans providing benefits solely to a business owner and his or her spouse, such as a Keogh or HR-10 plan, are not "covered plans" for purposes of the final rule.

The final rule generally maintains the categories of "covered service providers" as the interim final rule and maintains the $1,000 threshold for covered service providers. The final rule states that the focus of the $1,000 threshold is whether $1,000 is expected to be received in connection with the provision of services specified in the contract, regardless of whether the compensation is expected to be received in any given year or during the stated term of the contact. The Institute requested clarification on this issue in its comment letter.

In the preamble to the final rule, the Department also clarified that insurance brokers are intended to be treated as "covered service providers" under the category of "insurance services."

## New Investment Related Disclosures for Fiduciary Services

The final rule adds significant new disclosure requirements for those who are covered service providers because they provide fiduciary services to an investment contact, product or entity that holds plan assets and in which the covered plan has an equity investment. The final rule adds additional disclosure requirements for descriptions of the annual operating expenses of designated investment alternatives, if the return is not fixed. Specifically, the final rule requires that the disclosure include, for an investment contract product or entity that is a designated investment alternative, the total operating expense expressed as a percentage and calculated in accordance with the formula included in the participant disclosure regulation. [7]

Also, the final rule requires such covered service providers disclose any additional

information relating to designated investment alternatives that is within the control of, or reasonably available to, the covered service provider, if the information is considered investment-related information which must be provided automatically to participants under the participant disclosure regulation.

The preamble provides examples of this information, including identifying information such as the name and type or category of the alternative, performance data, benchmarks, and fee and expense information for alternatives for which the return is fixed. The preamble states that the covered service provider would not be responsible for preparing the glossary required by the participant disclosure regulation -- as that is not specific information about a particular designated investment alternative. [8]

In the preamble to the final rule, the Department states that this new requirement is intended to provide consistency for parties that are also required to comply with the participant disclosure regulation for designated investment alternatives in a participant-directed individual account plan.

## New Investment Related Disclosures for Recordkeeping and Brokerage Services

The final rule also adds new disclosure requirements to those who are covered service providers because they provide recordkeeping or brokerage services to a covered plan that is an individual account plan that permits participants to direct the investment of their accounts, if one or more designated investment alternatives will be made available (through a platform or similar mechanism) in connection with the recordkeeping or brokerage services provided.

The final rule for recordkeeping and brokerage services disclosures cross references and incorporates the additional new disclosures required for fiduciary services (discussed above). In this respect, recordkeepers and brokers must also disclose (1) the total operating expense expressed as a percentage and calculated in accordance with the formula included in the participant disclosure regulation, and (2) any additional information relating to designated investment alternatives that is within the control of, or reasonably available to the covered service provider, if the information is considered investment-related information which must be provided automatically to participants under the participant disclosure regulation. [9]

The Department further states that this new requirement is not intended to create a new or increased burden on a covered service provider or require a covered service provider to obtain or prepare information that otherwise is not within the covered service provider's control or reasonably available to the covered service provider. [10]

## Off Platform Investment Disclosures

In its comment letter, the Institute requested clarification regarding the disclosure obligations for off-platform investment alternatives designated by the plan sponsor. The Institute had observed that recordkeepers may not always have a direct relationship with the issuer of these off-platform investments. In the preamble to the final rule, the Department states that it continues to believe that the covered service provider is in the best position to furnish the required information and notes that to the extent that the covered service is not affiliated with the issuer of the designated investment alternative, it

may utilize the “pass-through” provision of the regulation.

The final rule made changes to the “pass-through” provision which the Department presumably believes will help recordkeepers comply with their obligations to provide the required disclosures. The Department states that a recordkeeper or broker may comply with the disclosure requirements by providing current disclosure materials of the issuer of the designated investment alternative or information replicated from such materials that includes the required disclosure information. In order to utilize the “pass through” provision the following three requirements must be met:

1. The issuer is not an affiliate of the covered service provider.

   The Institute, in its comment letter, requested a clarification of this requirement. In response, the Department confirmed in the preamble that covered service providers may pass through disclosure materials from affiliated issuers; however, covered service providers will be responsible for the content of the affiliated issuer materials.
2. 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 a financial institution supervised by state or federal agency.

   Whereas the interim final rule required that the disclosure materials be regulated by a state or federal agency, the final rule requires that the issuer of these materials be regulated by a state or federal agency.
3. The covered service provider must act in good faith and not know the materials are incomplete or inaccurate and must furnish the responsible plan fiduciary with a statement that the covered service provider is making no representations as to the completeness or accuracy of the materials.

   The Department states in the preamble that it included this provision in recognition that recordkeepers and brokers, unlike fiduciaries to investment vehicles holding plan assets, merely serve as intermediaries between plans and the issuers of the investment vehicles

# Application of Recordkeeping Definition to Transfer Agents

The Institute, in its comment letter, requested a clarification as to whether a transfer agent, who solely maintains a participant-level account, is considered a “recordkeeper” for purposes of the disclosure requirements. The Department did not directly address this issue, stating that the definition of “recordkeeping services” in the final rule is intended to be broad, and the required detailed explanation of the recordkeeping services being provided will enable the plan fiduciary to understand precisely the type of recordkeeping services being provided, so that comparisons among providers can be made.

# Description of Services

The final rule clarifies that a covered service provider must describe all services that will be provided to the covered plan pursuant to the contract or arrangement with the plan, including services to be provided by its affiliates and subcontractors – and not just the services it provides that make the service provider a “covered” service provider. In the

preamble to the final rule, the Department noted that it has not included additional standards, such as “plain English” disclosures for the description of services, and noted the responsible plan fiduciaries should seek assistance, either from the service provider or elsewhere, if they need help understanding any information furnished by the service provider.

## Disclosure of Indirect Compensation

The final rule includes an additional requirement regarding the disclosure of indirect compensation. In addition to identifying the services for which the indirect compensation will be received and the payer of the indirect compensation, the final rule requires that the covered service provider include “a description of the arrangement between the payer and the covered service provider, an affiliate, or a subcontractor as applicable, pursuant to which such indirect compensation is paid.”

## Guide to Initial Disclosure

The final rule does not require that a covered service provider furnish a guide or similar tool to enable the responsible plan fiduciary to locate compensation information disclosed through multiple documents. The final rule, however, reserves a place for the future development of a guide or similar tool and the Department stated it intends ultimately to publish a separate proposal for a guide or similar requirement. To encourage service providers to assist plan fiduciaries by providing a guide or summary, although not required at this time, the Department included a sample guide as an Appendix to the final rule. The Department states that a plan fiduciary that has difficulty finding and reviewing the required disclosures in lengthy or multiple disclosure documents from a covered service provider should consider inquiring about the feasibility and cost of using the sample guide.

## Electronic Delivery

In its comment letter on the interim final regulation, the Institute asked the Department to confirm that the disclosures required by the final regulation can be made electronically. The preamble to the final rule states that nothing in the regulation limits the ability of covered service providers to furnish information required by the regulation to responsible plan fiduciaries via electronic media. If the covered service provider’s disclosure information is on a website, it must be readily accessible to responsible plan fiduciaries, and fiduciaries must have clear notification on how to gain access.

## Changes to Initial Disclosures

The Institute, in its comment letter on the interim final regulations, recommended that the Department modify the regulation as it relates to changes to required investment-related information, as the interim final regulation appeared to require a covered service provider to disclose any changes within 60 days from the date the covered service provider is informed of the change. The final rule requires that changes to certain previously required disclosures (including services provided, fiduciary status, compensation, recordkeeping service disclosures, and manner of receipt of compensation) must continue to be provided within 60 days of a change. As the Institute recommended, however, changes to investment-related information may be made at least annually.

## Investment Menu Changes Designated by Plan Fiduciary

In its comment letter on the interim final regulation, the Institute requested clarification regarding the time period within which a covered service provider was required to disclose fee information on an investment alternative following a change by the plan fiduciary. The Institute noted that in many circumstances, disclosure prior to the date the plan investment alternative is "designated" by the plan fiduciary may not be workable because the plan fiduciary may notify the recordkeeper of the change after making its determination. In the preamble, the Department clarified that an investment menu change is considered a "change" to the initial disclosures. Therefore, changes to certain previously required disclosures (including services provided, fiduciary status, compensation, recordkeeping services disclosures, and manner of receipt of compensation) must continue to be provided within 60 days of a change. Changes solely to investment-related information, however, are required to be made at least annually.

## Timing of Reporting and Disclosure Information

The interim final rule required a covered service provider, upon the request of a responsible plan fiduciary or covered plan administrator, to furnish information relating to the compensation received by the covered service provider needed by the plan to comply with ERISA's reporting and disclosure provisions no later than 30 days following a request. The final rule retains this concept with two changes. First, the final rule clarifies that the request must be in writing. Second, the final rule changes the timing of the response – a covered service provider is required to provide this information reasonably in advance of the date upon which the plan fiduciary or covered plan administrator states that it must comply with the applicable reporting and disclosure requirement. If the disclosure is precluded due to extraordinary circumstances beyond the service provider's control, the information must be disclosed as soon as practicable.

## Disclosure Errors

The interim final rule provided that errors or omissions in initial disclosures must be corrected by the covered service provider as soon as practicable, but no later than 30 days after the covered service provider knows of the error or omission. The final rule extends this correction program to changes made to the initial disclosures.

## Use of Third Party Commercial Databases

In the preamble, the Department confirmed that a covered service provider's use of a "reputable and reliable" third party database as a source for investment information would ordinarily constitute disclosure made in good faith and with reasonable diligence. The Department stated that an important element in demonstrating reliability would be a contractual provision that makes the third-party provider responsible for ensuring that the information obtained from the central database is passed on accurately to the covered service provider. The Department noted that the covered service provider would need to disclose corrected information as soon as practicable, but not later than 30 days after becoming aware of an error or omission in the third-party data.

## Cost of Recordkeeping Services

The final rule changes the definition of "compensation" to include "compensation or cost" and allows for a reasonable and good faith estimate of compensation or cost if the covered service provider cannot readily describe compensation or cost if the covered service provider explains the methodology and assumptions used to prepare the estimate. Further, the final rule clarifies that all covered service providers, not just recordkeepers, may provide estimates of compensation or cost.

## Brokerage Window Indirect Compensation

In its comment letter, the Institute requested clarification regarding the disclosure requirements for brokerage windows, specifically with respect to indirect compensation. In the preamble, the Department confirmed that, because brokerage windows are not considered designated investment alternatives, investment-specific information does not have to be disclosed. However, the covered service provider must disclose all other required information including direct and indirect compensation. The Department stated that, although it understands that some of the required information (for example, with respect to compensation to be received) may depend on the investment ultimately selected by the participants through the brokerage window, it is confident that the final rule provides sufficient flexibility for how compensation may be disclosed.

## Class Exemption for Responsible Plan Fiduciary

The final rule makes one change to the conditions required under the class exemption for a responsible plan fiduciary. The exemption provides that a responsible plan fiduciary, upon discovering that a covered service provider has failed to disclose certain information, must request the information in writing from the covered service provider. Under the final rule, if the covered service provider fails to comply with the written request within 90 days, and the information relates to future services (services that will be performed after the 90-day period); the responsible plan fiduciary is to terminate the contract or arrangement as expeditiously as possible, consistent with ERISA's prudence requirements.

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**endnotes**

[1] A copy of the final regulation can be found here: http://www.dol.gov/ebsa/pdf/2012-02262-PI1.pdf.

[2] For a description of the Interim Final Regulation, see Memorandum to Pension Members No. 29-10, Bank Trust and Recordkeeper Advisory Committee No. 21-10, Operations Committee No. 18-10, Transfer Agent Advisory Committee No. 37-10 [24432], dated July 16, 2010.

[3] See Memorandum to Pension Members No. 36-10, Bank Trust and Recordkeeper Advisory Committee No. 30-10, Operations Committee No. 24-10, Transfer Agent Advisory Committee No. 52-10 [24520], dated August 30, 2010.

[4] See Memorandum to Pension Members No. 8-08, Bank Trust and Recordkeeper

Advisory Committee No. 6-08, Statistical Advisory Group, Transfer Agent Advisory Committee No. 8-08 [22232], dated February 13, 2008. For a description of the initial proposed regulation see Memorandum to Pension Members No. 75-07 [22053], dated December 17, 2007.

[5] See Memorandum to Pension Committee No. 4-12, Pension Operations Advisory Committee No. 4-12 [25848], dated January 26, 2011 for a link to the DOL Rule page regarding the Summary Disclosure Notice of Proposed Rulemaking.

[6] The first quarterly statement to participants that includes the new required participant disclosures is to be made no later than November 14, 2012 --45 days after the end of the third quarter (July-September) in which the initial disclosure was required. See Memorandum to Pension Members No. 40-11, Operations Members No. 14-11, Bank Trust and Recordkeeper Advisory Committee No. 41-11, Transfer Agent Advisory Committee No. 55-11 [25330], dated July 14, 2011. For a description of the Department's extension proposal, See Memorandum to Pension Members No. 26-11, Operations Members No. 11-11, Bank, Trust, and Recordkeeper Advisory Committee No. 31-11, and Transfer Agent Advisory Committee No. 41-11 [25237], dated June 1, 2011. For our comment letter on the proposed extension, see Memorandum to Pension Members No. 32-11, Operations Members No. 12-11, Bank, Trust and Recordkeeper Advisory Committee No. 34-11, and Transfer Agent Advisory Committee No. 46-11[25279], dated June 14, 2011.

[7] See 29 CFR §2550.404a-5(h)(2). For a description of the Final Participant Disclosure regulation, see Memorandum to Pension Members No. 49-10, Transfer Agent Advisory Committee No. 76-10, Bank, Trust and Recordkeeper Advisory Committee No. 49-10, Broker/Dealer Advisory Committee No. 56-10, Operations Committee No. 37-10 [24702], dated November 11, 2010.

[8] The Institute and the Spark Institute developed a sample glossary of investment-related terms for purposes of the participant disclosure regulation. See Memorandum to Pension Members No. 70-11 [25725], dated December 19, 2011.

[9] See 29 CFR §2550.404a-5(d)(1).

[10] The Department provides an example in the preamble: in the case of a recordkeeper that offers a platform of designated investment alternatives consisting of mutual funds, the recordkeeper could satisfy its obligations by passing through to the covered plan the prospectuses for the funds, in view of the fact that these disclosures would contain much of the required information and be reasonably available to the recordkeeper.

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