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29 CFR Part 2550

Reasonable Contract or Arrangement Under Section 408(b)(2)—Fee Disclosure; Interim Final Rule

DEPARTMENT OF LABOR

Employee Benefits Security Administration

29 CFR Part 2550

RIN 1210–AB08

Reasonable Contract or Arrangement Under Section 408(b)(2)—Fee Disclosure

AGENCY: Employee Benefits Security Administration, Labor.

ACTION: Interim final rule with request for comments.

SUMMARY: This document contains an interim final regulation under the Employee Retirement Income Security Act of 1974 (ERISA or the Act) requiring that certain service providers to employee pension benefit plans disclose information to assist plan fiduciaries in assessing the reasonableness of contracts or arrangements, including the reasonableness of the service providers' compensation and potential conflicts of interest that may affect the service providers' performance. These disclosure requirements are established as part of a statutory exemption from ERISA's prohibited transaction provisions. This regulation will affect employee pension benefit plan sponsors and fiduciaries and certain service providers to such plans. Interested persons are invited to submit comments on the interim final regulation for consideration by the Department of Labor.

DATES: *Effective date.* This interim final rule is effective on July 16, 2011.

Comment date. Written comments on the interim final rule must be received by August 30, 2010.

ADDRESSES: To facilitate the receipt and processing of comments, EBSA encourages interested persons to submit their comments electronically to *e-ORI@dol.gov,* or by using the Federal eRulemaking portal *http://www.regulations.gov* (following instructions for submission of comments). Persons submitting comments electronically are encouraged not to submit paper copies. Persons interested in submitting comments on paper should send or deliver their comments (preferably three copies) to: Office of Regulations and Interpretations, Employee Benefits Security Administration, Room N–5655, U.S. Department of Labor, 200 Constitution Avenue, NW., Washington, DC 20210, Attention: 408(b)(2) Interim Final Rule. All comments will be available to the public, without charge, online at *http://www.regulations.gov* and *http://www.dol.gov/ebsa,* and at the Public Disclosure Room, Employee Benefits Security Administration, U.S. Department of Labor, Room N–1513, 200 Constitution Avenue, NW., Washington, DC 20210.

FOR FURTHER INFORMATION CONTACT: For further information on the interim final regulation, contact Allison Wielobob or Fil Williams, Office of Regulations and Interpretations, Employee Benefits Security Administration, (202) 693–8510. This is not a toll-free number.

SUPPLEMENTARY INFORMATION:

A. Background

1. General

In recent years, there have been a number of changes in the way services are provided to employee benefit plans and in the way service providers are compensated. Many of these changes may have improved efficiency and reduced the costs of administrative services and benefits for plans and their participants. However, the complexity resulting from these changes also has made it more difficult for plan sponsors and fiduciaries to understand what service providers actually are paid for the specific services rendered.

Despite these complexities, section 404(a)(1) of ERISA requires plan fiduciaries, when selecting or monitoring service providers and plan investments, to act prudently and solely in the interest of the plan's participants and beneficiaries and for the exclusive purpose of providing benefits and defraying reasonable expenses of administering the plan. Fundamental to a plan fiduciary's ability to discharge these obligations is the availability of information sufficient to enable the plan fiduciary to make informed decisions about the services, the costs, and the service provider. Although the Department of Labor (Department) has issued technical guidance and compliance assistance materials relating to the obligations of plan fiduciaries in selecting and monitoring service providers,[1] the Department continues to believe that, given plan fiduciaries' need for complete and accurate information about compensation and revenue sharing, both plan fiduciaries and service providers would benefit from regulatory guidance in this area. For this reason, the Department published a notice of proposed rulemaking in the **Federal Register** (72 FR 70988) on December 13, 2007. On the same day, the Department also published a proposed class exemption from the restrictions of section 406(a)(1)(C) of ERISA in the **Federal Register** (72 FR 70893). The Department proposed the exemption on its own motion pursuant to section 408(a) of the Act, and in accordance with the procedures set forth in 29 CFR part 2570, subpart B (55 FR 32836, August 10, 1990).

2. Public Comments on Proposed Regulation and Class Exemption

The Department's proposal required that reasonable contracts and arrangements between employee benefit plans and certain providers of services to such plans include specified information to assist plan fiduciaries in assessing the reasonableness of the compensation paid for services and the conflicts of interest that may affect a service provider's performance of services. The proposal also was designed to assist plan fiduciaries and administrators in obtaining the information they need from service providers to satisfy their reporting and disclosure obligations.[2] Interested persons were invited to submit comments on the proposal. In response to this invitation, the Department received over 100 written comments on the proposed regulation and class exemption from a variety of parties, including plan sponsors and fiduciaries, plan service providers, financial institutions, and employee benefit plan and participant industry representatives. These comments are available for review under "Public Comments" on the "Laws & Regulations" page of the Department's Employee Benefits Security Administration Web site at *http://www.dol.gov/ebsa.*

Due to the large number of public comments received, the importance of this regulatory initiative, and its potentially significant effects on the provision of services to employee benefit plans, the Department held a public hearing on March 31 and April 1, 2008, in order to further develop the public record and the Department's understanding of the issues raised in the

[1] *See, e.g.,* Field Assistance Bulletin 2002–3 (November 5, 2002), Advisory Opinions 97–16A (May 22, 1997) and 97–15A (May 22, 1997), *http://www.dol.gov/ebsa/publications/undrstndgrtrmnt.html,* and *http://www.dol.gov/ebsa/newsroom/fs053105.html.*

[2] The Department also implemented changes to the information required to be reported concerning service provider compensation as part of the Form 5500 Annual Report. These changes to Schedule C of the Form 5500 complement the interim final rule under ERISA section 408(b)(2) in assuring that plan fiduciaries have the information they need to monitor their service providers consistent with their duties under ERISA section 404(a)(1). *See* 72 FR 64731; *see also* frequently asked questions on Schedule C, at *http://www.dol.gov/ebsa/faqs/faq-sch-C-supplement.html* and *http://www.dol.gov/ebsa/faqs/faq_scheduleC.html.*

public comments. As a result of the public hearing, the Department received a significant number of additional comments to supplement the public record for this regulatory initiative. These supplemental materials also are available for review on the Department's Web site.

Set forth below is an overview of the interim final regulation and the public comments received on the proposal and during the Department's public hearing.

B. Overview of Interim Final Regulation Under ERISA Section 408(b)(2) and Public Comments

The Department's interim final regulation (for simplicity, the interim final regulation also is referred to herein as the final regulation) retains the basic structure of the proposal by requiring that covered service providers satisfy certain disclosure requirements in order to qualify for the statutory exemption for services under ERISA section 408(b)(2). The furnishing of goods, services, or facilities between a plan and a party in interest to the plan generally is prohibited under section 406(a)(1)(C) of ERISA. As a result, a service relationship between a plan and a service provider would constitute a prohibited transaction, because any person providing services to the plan is defined by ERISA to be a "party in interest" to the plan. However, section 408(b)(2) of ERISA exempts certain arrangements between plans and service providers that otherwise would be prohibited transactions under section 406 of ERISA. Specifically, section 408(b)(2) provides relief from ERISA's prohibited transaction rules for service contracts or arrangements between a plan and a party in interest 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. Regulations issued by the Department clarify each of these conditions to the exemption.[3]

This rule amends the regulation under ERISA section 408(b)(2) to clarify the meaning of a "reasonable" contract or arrangement for covered plans. Currently, the regulation at 29 CFR 2550.408b-2(c) states only that a contract or arrangement is not reasonable unless it permits the plan to terminate without penalty on reasonably short notice. The final regulation establishes a requirement under section 408(b)(2) that, in order for certain contracts or arrangements for services to be reasonable, the covered service provider must disclose specified information to a responsible plan fiduciary, defined as a fiduciary with authority to cause the plan to enter into, or extend or renew, a contract or arrangement for the provision of services to the plan. The specific disclosure requirements are described in more detail below.

The final regulation differs from the proposal in a number of significant respects, each discussed in this rule. First, unlike the proposal, the final rule does not require a formal written contract or arrangement delineating the disclosure obligations, even though the disclosures must be made in writing. The final rule focuses instead on the substance of the disclosure that must be provided. Second, the final rule treats separately pension and welfare plans. Paragraph (c)(1) of the rule published today provides disclosure requirements applicable to contracts or arrangements with pension plans. The Department reserves paragraph (c)(2) of the rule for future guidance on disclosure with respect to welfare plans.

Third, the final rule modifies the categories of service providers that must comply with the disclosure requirements, including fiduciaries, investment advisers, and recordkeepers or brokers who make investment alternatives available to a plan. It also applies to providers of other specified services who receive either "indirect compensation" (generally from sources other than the plan or plan sponsor) or certain types of payments from affiliates and subcontractors. The final rule includes in its definition of "covered service providers" fiduciaries to investment vehicles that hold plan assets and in which a covered plan has a direct equity investment. However, the definition makes clear that furnishing non-fiduciary services to such vehicles, or services to vehicles that do not hold plan assets will not cause a person to be a covered service provider. In addition, the regulation requires fiduciaries to plan asset investment vehicles in which plans make direct equity investments, as well as parties that offer designated investment alternatives to a participant-directed individual account plan as part of a platform, to furnish investment-related compensation information.

Fourth, the final rule, unlike the proposal, does not contain specific narrative conflict of interest disclosure provisions, but rather relies on full disclosure of the circumstances under which the covered service provider will be receiving compensation from parties other than the plan (or plan sponsor), the identification of such parties, and the compensation that is expected to be received. As discussed below, the Department is persuaded that plan fiduciaries will be in a better position to assess potential conflicts of interest by reviewing these specific parties and the actual or expected compensation to be received from such parties. Fifth, the final rule includes a new provision requiring that certain providers of multiple services disclose separately the cost to the covered plan of recordkeeping services. Sixth, the final rule specifically addresses the application of the requirements of the regulation to section 4975 of the Internal Revenue Code (the Code). And, lastly, the exemptive relief for plan sponsors or other responsible plan fiduciaries, originally proposed as a separate exemption, is now incorporated into the final rule for ease of reference and consideration by interested parties. A more detailed discussion of the final rule, including these changes, is set forth below.

As required by Executive Order 12866, the Department evaluated the benefits and costs of this final rule. The Department believes that mandatory proactive disclosure will reduce sponsor information costs, discourage harmful conflicts, and enhance service value. Additional benefits will flow from the Department's enhanced ability to redress abuse. Although the benefits are difficult to quantify, the Department is confident they more than justify the cost. The Department estimated costs for the rule over a ten-year time frame for purposes of this analysis and used information from the quantitative characterization of the service provider market presented below as a basis for these cost estimates. This characterization did not account for all service providers, but it does provide information on the segments of the service provider industry that are likely to be most affected by the rule (*i.e.,* those with contracts listed on the Form 5500). In addition to the costs to service providers, the Department also considered, and discusses below, the potential costs to plans.

In accordance with OMB Circular A–4,[4] Table 1 below depicts an accounting statement showing the Department's assessment of the benefits and costs associated with this regulatory action.

[3] *See* 29 CFR 2550.408b–2.

[4] Available at *http://www.whitehouse.gov/omb/circulars/a004/a-4.pdf.*

TABLE 1—ACCOUNTING TABLE

Category	Primary estimate	Year dollar	Discount rate	Period covered
Benefits				
Annualized Monetized ($millions/year)	Not Quantified.			
Qualitative: The final regulation will increase the amount of information that service providers disclose to plan fiduciaries. Non-quantified benefits include information cost savings, discouraging harmful conflicts of interest, service value improvements through improved decisions and value, better enforcement tools to redress abuse, and harmonization with other EBSA rules and programs.				
Costs Annualized Monetized ($millions/year)	58.7 54.3	2010 2010	7% 3%	2011–2020 2011–2020
Qualitative: Costs include costs for service providers to perform compliance review and implementation, for disclosure of general, investment-related, and additional requested information, for responsible plan fiduciaries to request additional information from service providers to comply with the exemption and to prepare notices to DOL if the service provider fails to comply with the request.				
Transfers	Not Applicable.			

A more detailed discussion of the need for this regulatory action, consideration of regulatory alternatives, and assessment of benefits and costs are included in Section K—"Regulatory Impact Analysis" below.

1. General

The final regulation, like the proposal, amends paragraph (c) of § 2550.408b–2 by moving, without change, the current provisions of paragraph (c) to a newly designated paragraph (c)(3) and adding new paragraphs (c)(1) and (2) to address the disclosure requirements applicable to a "reasonable contract or arrangement." Paragraph (c)(1) describes the disclosure requirements for pension plans. Paragraph (c)(2) has been reserved for future guidance concerning the disclosure requirements for welfare plans.

The general paragraph of the final rule, paragraph (c)(1)(i), provides that no contract or arrangement for services between a covered plan and a covered service provider, nor any extension or renewal, is reasonable within the meaning of ERISA section 408(b)(2) and this regulation unless the requirements of the regulation are satisfied. The terms "covered plan" and "covered service provider" are defined in paragraph (c)(1)(ii) and (iii), respectively. The general paragraph also provides that the regulation's disclosure requirements are independent of a fiduciary's obligations under section 404 of ERISA.

2. Scope—Covered Plans

Paragraph (c)(1)(ii) defines a "covered plan" to mean an employee pension benefit plan or a pension plan within the meaning of ERISA section 3(2)(A) (and not described in ERISA section 4(b)), except that such term shall not include a "simplified employee pension" described in section 408(k) of the Code, a "simple retirement account" described in section 408(p) of the Code, an individual retirement account described in section 408(a) of the Code, or an individual retirement annuity described in section 408(b) of the Code.

Under the proposal, all employee benefit plans subject to Title I of ERISA, including employee pension benefit plans and welfare benefit plans, were subject to the regulation's disclosure requirements. The Department received many comments and heard testimony from parties concerned about the implications of subjecting defined benefit plans, welfare benefit plans, and individual retirement accounts (IRAs) to the regulation.[5]

Commenters questioned the proposal's application to defined benefit plans for a variety of reasons, suggesting that the Department consider separate guidance for defined benefit plans. Commenters argued that sponsors of defined benefit plans and their service providers have only recently joined the public policy discussion regarding fee disclosure for retirement plans. They believe that a thorough examination of the issues that affect defined benefit plans is warranted before disclosure rules apply with respect to their service providers.

In advocating for separate rules for defined benefit plans, some commenters focused on the differences in the legal structures of defined benefit plans and defined contribution plans. In addition, commenters noted that services are provided to defined benefit plans in ways that are materially different than they are for defined contribution plans. Other commenters noted that employers have incentives to monitor and negotiate service provider fees and expenses for defined benefit plans, because these plans primarily rely on employer contributions; excessive fees and expenses would make it more expensive for the employer to fund promised benefits. In contrast, defined contribution plans are funded primarily by employee contributions, and employers may pass on up to 100 percent of plan costs to employees.

After careful review of the comments, the Department is not persuaded that the information fiduciaries of defined benefit plans need to make informed decisions about their service providers is fundamentally different from the information fiduciaries of defined contribution plans need to make informed decisions. Nor is the Department persuaded that the service provider relationships between the two types of plans are so different as to justify exclusion of defined benefit plans from the regulation's disclosure requirements. Moreover, the Department does not believe that compliance with the disclosure requirements, particularly as modified from the proposal, will present any unreasonable compliance burdens for service providers to defined benefit plans. For these reasons, the final rule, like the proposal, applies to contracts and arrangements with covered service providers to both defined contribution and defined benefit plans.

The Department also received many comments concerning the applicability of the proposal to welfare benefit plans. Many commenters recommended their exclusion from the scope of the final

[5] A few commenters suggested that the Department not extend the final rule to small plans (for example, those with less than 100 participants). The Department was not persuaded that any policy rationale exists for excluding small plans.

rule. Some commenters believe that the Department's rationales for the proposed rule apply to pension plans but not to welfare benefit plans. Other commenters maintain that, if the Department creates a disclosure regime for welfare benefit plan service providers, it should be promulgated separately.

Commenters articulated specific concerns relating to welfare benefit plans, including the potential for negative effects on the insurance industry, which, they argue, is highly regulated by State laws. Many commenters asserted that, considering the high level of State regulation, subjecting welfare benefit plans to the disclosure regulation would be unnecessary and redundant because the disclosures contemplated in the regulation are already made available to plan fiduciaries through State regulatory processes. Other commenters pointed out that most State insurance laws do not require the types of disclosures addressed under the proposed rule and even where such State laws exist, they are loosely enforced. Still others asserted that there are "transparency problems" in general in the health and welfare industry.

Some commenters expressed views relating to prohibited transaction exemption (PTE) 84–24,[6] which they indicated is often misinterpreted and improperly utilized by service providers to suit their purposes. Those in favor of subjecting welfare benefit plans to the regulation said that it would eliminate the limitations of PTE 84–24. Other commenters asserted that PTE 84–24 has worked well and that welfare benefit plans should be allowed to continue without the impact of new disclosure obligations under the proposal.

Still other commenters addressed specific concerns of pharmacy benefit managers (PBMs), which are intermediaries between drug manufacturers and health insurance plans. They believe that the reasons for disclosure discussed in the preamble to the proposed rule are inapplicable to PBMs. According to some commenters, the Federal Trade Commission has thoroughly evaluated the industry, finding that market forces provide sufficient information to plan fiduciaries and that excessive mandatory disclosure could weaken competition, such that the proposed regulation would negatively affect the delivery of prescription drugs to plan beneficiaries. Other commenters disputed the idea that PBMs should not be subject to the regulation, arguing that the discounts and rebates they received from drug companies were examples of undisclosed indirect compensation. Commenters offering this point of view did not present any further official comment or testimony at the public hearing.

In spite of these arguments, the Department believes that fiduciaries and service providers to welfare benefit plans would benefit from regulatory guidance in this area for the same reasons that apply to defined contribution plans and defined benefit plans. However, the Department is persuaded, based on the public comment and hearing testimony, that there are significant differences between service and compensation arrangements of welfare plans and those involving pension plans and that the Department should develop separate, and more specifically tailored, disclosure requirements under ERISA section 408(b)(2) for welfare benefit plans. Accordingly, the interim final rule published today includes a new paragraph (c)(2), which has been reserved for a comprehensive disclosure framework applicable to "reasonable" contracts or arrangements for services to welfare plans to be developed by the Department. The Department notes, however, that in the meantime, ERISA section 404(a) continues to obligate fiduciaries to obtain and consider information relating to the cost of plan services and potential conflicts of interest presented by such service arrangements.

Several commenters requested clarification regarding the regulation's application to IRAs or similar accounts. In some cases, commenters argued that the Department should exclude such accounts, as well as other plans that are not subject to Title I of ERISA, from the scope of the final regulation. The commenters observed that there are significant categories of arrangements that are subject to the prohibited transaction provisions of section 4975 of the Code, but not those of ERISA, and that do not have a fiduciary overseeing the plan. The comments asserted that owners of IRAs and other individual arrangements are more like individual plan participants than plan fiduciaries and that it would be inappropriate to impose the service provider-to-plan disclosure requirements in the context of non-ERISA arrangements. In contrast to participant-directed individual account plans, which typically offer a limited number of investment options, many IRAs offer a large number of investment options, such as brokerage accounts with essentially unlimited choices. Providing the disclosures set forth in the proposal could be quite burdensome and costly as a result. These costs, commenters argue, may drive service providers to limit the number of investment choices available in IRAs. In addition, some commenters pointed out that, under securities laws, the IRA accountholder is treated as the actual owner of the securities held in his or her IRA and is entitled to all securities law disclosures in the same manner as if the accountholder owned those securities directly. In contrast, with ERISA-covered plans, disclosure obligations under the securities laws extend only to the plan itself, not to individual plan participants.

The Department does not believe that IRAs should be subject to the final rule, which is designed with fiduciaries of employee benefit plans in mind. An IRA account-holder is responsible only for his or her own plan's security and asset accumulation. They should not be held to the same fiduciary duties to scrutinize and monitor plan service providers and their total compensation as are plan sponsors and other fiduciaries of pension plans under Title I of ERISA, who are responsible for protecting the retirement security of greater numbers of plan participants. Moreover, IRAs generally are marketed alongside other personal investment vehicles. Imposing the regulation's disclosure regime on IRAs could increase the costs associated with IRAs relative to similar vehicles that are not covered by the regulation. Therefore, although the final rule cross references the parallel provisions of section 4975 of the Code, paragraph (c)(1)(ii) provides explicitly that IRAs and certain other accounts and plans are not covered plans for purposes of the rule.

3. Scope—Covered Service Providers

The categories of service providers covered by the final rule, in paragraph (c)(1)(iii), vary slightly from those described in the proposal. The proposed regulation generally included service providers falling into one of the following categories: (1) Fiduciary service providers, whether under ERISA or under the Investment Advisers Act of 1940; (2) service providers that will perform banking, consulting, custodial, insurance, investment advisory, investment management, recordkeeping,

[6] 49 FR 13208 (Apr. 3, 1984); amended at 71 FR 5887 (Feb. 3, 2006) (providing prohibited transaction relief for service arrangements and related plan transactions involving insurance agents and brokers, pension consultants, insurance and investment companies, and investment company principal underwriters; for example, PTE 84–24 permits these parties to place insurance products with plans when they are fiduciaries, or affiliated with fiduciaries, to the plans if certain conditions are met).

or third party administration services for the plan; or (3) service providers that will receive indirect compensation in connection with providing accounting, actuarial, appraisal, auditing, legal, or valuation services to the plan. The Department believed that these service arrangements, and their associated compensation structures, were the most likely to give rise to conflicts of interest.

The Department received a number of comments requesting clarification as to which entities were intended to be "service providers" for purposes of the proposal, both in terms of which service providers are responsible for complying with the proposal's written contract requirement, and who is considered a service provider such that their compensation and conflict of interest information must be disclosed to the responsible plan fiduciary. Some commenters argued that the proposal's disclosure requirements should be limited to service providers that deal directly with employee benefit plans, or that customarily are in contractual privity with the plan, and questioned the application of the rule to indirect service providers. These commenters were concerned that the proposed rule appears to apply, potentially without limit, to "indirect" service providers, for example a service provider to a direct service provider, or a service provider to an investment provider or mutual fund company; in some cases, they argue, the services provided by these indirect providers bear little or no relation to the particular plan service arrangement in question. For example, commenters questioned whether the proposed disclosure requirements would apply to a copy service, if a plan recordkeeper subcontracts with that copy service to perform administrative functions for both the recordkeeper and its plan clients, or to legal counsel to a registered investment company, when counsel's role is limited to ensuring that the company complies generally with applicable securities laws.

In connection with their request that the Department clarify whether providers of services to a plan service provider, or to an investment provider, are themselves service providers to the plan for purposes of the disclosure requirements of the proposed rule, some commenters note that confusion on this issue may stem from language of the proposed rule that adopted the view taken by the Department as to who is a "service provider" for purposes of reporting service provider compensation on the recent Form 5500, Schedule C, revisions. The new Schedule C reporting requirements are not limited to information concerning the compensation of persons with direct service provider relationships to a plan but also include compensation information regarding persons who provide services to investment vehicles in which plans invest. Commenters questioned whether a similar position is appropriate in the context of a prohibited transaction for which relief is obtained under section 408(b)(2).

Other commenters raised concerns about the proposal insofar as it was interpreted as raising technical issues under the Department's plan asset guidance.[7] For example, several commenters questioned whether and how the proposed disclosure requirements would apply to service providers to "non-plan asset" vehicles, an issue that often arises in the context of plan investments. For instance, commenters observed that mutual funds, real estate operating companies, venture capital operating companies, and private equity funds that do not have significant equity participation by "benefit plan investors" (*i.e.,* 25% or more of any class of equity interest held by such investors) are not plan asset vehicles, and thus managers of these entities are not ERISA fiduciaries. These commenters argued that the proposed disclosure requirements also should not apply to any person who is providing services to a non-plan asset vehicle.

The Department believes that the definition of covered service provider contained in the final rule addresses the ambiguities raised by the commenters and reflects the Department's intent to focus on contracts or arrangements between covered plans and fiduciaries, platform providers and other specified service providers dealing directly with covered plans who may receive indirect compensation or certain compensation from related parties. The Department notes that the parties that must be reported as service providers for Schedule C purposes will not necessarily be the same as the parties that will be covered service providers for purposes of this rule.

The Department continues to believe that requiring every service provider to a plan to satisfy the disclosure requirements of this regulation may not be appropriate or yield helpful information to plan fiduciaries. The Department also believes that certain service providers, because of the nature of the services that they provide to pension plans, the potential influence they have on plan fiduciaries' decisions and on the plan services that they ultimately will provide, or the complexity of their compensation arrangements, must provide comprehensive information to plan fiduciaries about the compensation that they will be paid for their services. The Department is sensitive to the technical and practical issues raised by commenters about how the scope of this rule will be applied to various parties in the employee benefit plan industry. The Department also agrees with commenters that service providers and plan fiduciaries would benefit from more certainty as to whether any particular service contract or arrangement will be required to comply with this rule. The Department believes that the interim final rule, in terms of defining the service providers covered by the rule, responds to the concerns of these commenters. However, the Department welcomes comments from interested persons who continue to have concerns about the scope of service providers covered by the interim final rule.

Paragraph (c)(1)(iii) of the final rule defines the term "covered service provider." Among other changes, the final rule establishes a $1,000 threshold for service providers otherwise coming within the definition of a covered service provider (regardless of whether the threshold is met by compensation received by the covered service provider, an affiliate, or a subcontractor that is performing one or more of the services to be provided under the contract or arrangement with the covered plan). A "covered service provider" is a service provider that enters into a contract or arrangement with the covered plan and reasonably expects to receive $1,000 or more in compensation, direct or indirect, to be received in connection with providing one or more specified services. The Department included the $1,000 threshold in response to commenters' request that the final rule exclude contracts or arrangements that involve de minimis amounts of compensation. In these circumstances, the Department is persuaded that the parties to these relatively small service contracts or arrangements may not need to provide the detailed disclosures required under this rule in order to ensure that plan fiduciaries have the information they need to make informed decisions about the services and cost of the services to be provided. Commenters did not suggest a particular minimum amount for such contracts or arrangements, but the Department believes that $1,000 is a reasonable threshold amount to address their concerns. As this is an interim final rule, the Department welcomes

[7] *See* 29 CFR 2510.3–101.

additional input from commenters on our decision.

The types of service providers covered by the final regulation fall into three categories, and each category is discussed below. A service provider may be a covered service provider under the final rule even if some or all of the services provided pursuant to the contract or arrangement are performed by affiliates of the covered service provider or subcontractors. Further, as noted in paragraph (c)(1)(iii)(D)(*1*), service providers do not become "covered service providers" solely as a result of services that they perform in their capacity as an affiliate of the covered service provider or a subcontractor.

The first category of covered service providers, in paragraph (c)(1)(iii)(A), includes those providing services as an ERISA fiduciary or as an investment adviser registered under either the Investment Advisers Act of 1940 (Advisers Act) or any State law. This category is split into three subsections. Subparagraph (*1*) includes ERISA fiduciaries providing services directly to the covered plan.

Subparagraph (*2*) includes ERISA fiduciaries providing services to an investment contract, product, or entity that holds plan assets and in which the covered plan has a direct equity investment. These service providers are ERISA fiduciaries by virtue of providing services to a plan asset investment vehicle, rather than providing services directly to the covered plan. The Department placed these fiduciaries of plan asset vehicles in a separate subcategory because, under the final rule, these fiduciaries have an additional obligation to disclose compensation information about the investment vehicle for which they serve as a fiduciary.

This subcategory includes fiduciaries to the initial-level investment vehicle in which the covered plan makes a direct equity investment and which holds plan assets. However, it does not include fiduciaries to that initial vehicle's underlying investments, even though such down-level investment vehicles also may hold "plan assets." The determination of whether an investment contract, product, or entity holds "plan assets" is made under sections 3(42) and 401 of ERISA and the regulation at 29 CFR 2510.3–101. The regulation uses the term "direct equity investment" to distinguish the covered plan's initial-level investment in an investment contract, product, or entity from investments made by such initial-level contract, product or entity in which the plan invests, without regard to whether the underlying, second-tier investment vehicles hold plans assets. Specifically, the regulation provides that a direct equity investment does not include investments made by the investment contract, product, or entity in which the covered plan invests.

Subparagraph (*3*) includes investment advisers providing services directly to the covered plan. This provision has been modified from the proposal to require disclosure from an investment adviser "registered" under either the Advisers Act or State law, rather than a "fiduciary" under the Advisers Act.

The Department received a number of comments concerning the requirement to identify services as "fiduciary" services under ERISA or the Advisers Act. In general, commenters argued that whether such services will be provided may be unclear, given the facts-and-circumstances nature of fiduciary status under section 3(21) of ERISA, creating an unnecessary level of uncertainty for both plan fiduciaries and service providers in terms of compliance with the regulation. Commenters also argued that by including fiduciaries under the Advisers Act, the proposal included advisers that may not be registered under the Advisers Act, thereby adding a degree of uncertainty as to which service providers might be covered by the rule. Other commenters argued that plan sponsors may be confused as to whether a particular service provider is acting as a fiduciary under ERISA or as a fiduciary under the Advisers Act. The Department believes that the modifications reflected in paragraph (c)(1)(iii)(A) of the final rule respond to these concerns. The Department continues to believe, however, that it is important for plan fiduciaries to know whether a party will be providing or reasonably expects to provide services to the plan as an ERISA fiduciary or as a registered investment adviser.[8] See paragraph (c)(1)(iv)(B) relating to the requirement that this status be disclosed to the responsible plan fiduciary.

The second category of covered service providers, in paragraph (c)(1)(iii)(B), includes providers of recordkeeping services or brokerage services to a covered plan that is an individual account plan (under ERISA section 3(34)) and that permits participants and 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. This category encompasses recordkeepers and brokers that offer, as part of their contract or arrangement, a platform of investment options, or a similar mechanism, to a participant-directed individual account plan. This category also encompasses service providers who provide recordkeeping or brokerage services that include designated investment alternatives independently selected by the responsible plan fiduciary and which are later added to the covered plan's platform. Under the proposal, these service providers had no disclosure obligations beyond those directly relating to the services they were providing as recordkeepers or brokers for the plan. Under the interim final rule, however, covered service providers in this category, as discussed later, must disclose to the responsible plan fiduciary compensation information regarding each of the designated investment alternatives for which they provide recordkeeping or brokerage services. See paragraphs (c)(1)(iii)(B) and (c)(1)(iv)(G). The term "designated investment alternative" is defined in paragraph (c)(1)(viii)(C), discussed below.

The third category of covered service providers, in paragraph (c)(1)(iii)(C), includes those providing specified services to the covered plan when the covered service provider (or an affiliate or a subcontractor) reasonably expects to receive "indirect" compensation or certain payments from related parties. As discussed below, the terms "affiliate", "indirect compensation," and "subcontractor" are defined in paragraph (c)(1)(viii) of the final regulation. The services included in this category are 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.

The services in the final rule's third category generally are the same as those in the proposal. However, whether or not these services will cause a service provider to be a covered service

[8] To the extent a service provider is a "dual registrant" (*i.e.,* an investment adviser registered under the Advisers Act and a broker-dealer registered under the Securities Exchange Act of 1934, as amended), the service provider would be a covered service provider under paragraph (c)(1)(iii)(A)(*3*) only when acting as an investment adviser to a covered plan, and not when acting merely as a broker-dealer to such plan. However, broker-dealers to covered plans may be covered service providers under paragraph (c)(1)(iii)(B) or (C), as discussed further below.

provider under the rule depends upon the expectation by the covered service provider, its affiliate, or a subcontractor of receiving certain types of compensation, namely indirect compensation or compensation paid by related parties. A few commenters asked the Department to define the types of services referenced in the proposal. Although the Department understands that there may be, in some instances, subtle differences in how employee benefits services are described and, therefore, some clarification may be helpful, the Department also is concerned that too much specificity may have the undesirable effect of narrowing the application of the regulation solely on the basis of an overly technical definition. The Department believes that the financial industry and employee benefits community have a reasonable understanding of the services referenced in the regulation and that any remaining ambiguity will not result in undue burdens attendant to compliance with the final rule.

Nonetheless, the Department, in response to commenters, has attempted to narrow the scope of the term "consulting" by adding a parenthetical clarifying that "consulting" as used in the final regulation is consulting related to the development or implementation of investment policies or objectives, or the selection or monitoring of service providers or plan investments. Also, it should be noted that investment advisory services are included in both the first and third categories of covered service providers, but the investment advisers who are covered in each category may be different. The first category includes only *registered* investment advisers, even if they receive only direct compensation from the covered plan. The third category includes investment advisers that reasonably expect to receive compensation that is indirect or paid from related parties, whether or not they are registered investment advisers.

Paragraph (c)(1)(iii)(D) of the final regulation clarifies that, notwithstanding the preceding categories of "covered service providers," no person or entity is a "covered service provider" solely by providing services (1) as an affiliate or a subcontractor that is performing one or more of the services to be provided under the contract or arrangement with the covered plan (see paragraph (c)(1)(iii)(D)(*1*)), or (2) 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 as a fiduciary described in paragraph (c)(1)(iii)(A)(*2*) (see paragraph (c)(1)(iii)(D)(*2*)). In other words, paragraph (c)(1)(iii)(D)(*1*) clarifies that the concept of a "covered service provider" captures only the party directly responsible to the covered plan for the provision of services under the contract or arrangement, even though some or all of such services may be performed by an affiliate or subcontractor. In the view of the Department, the service provider directly responsible to the plan for the provision of services is the appropriate party to ensure that the required disclosures under the regulation are made. Paragraph (c)(1)(iii)(D) addresses the possibility of multiple disclosure obligations with respect to the same services.

Paragraph (c)(1)(iii)(D)(*2*) further clarifies that, other than providers of fiduciary services to an investment contract, product, or entity holding plan assets with respect to which the covered plan has a direct equity investment (described above), the term "covered service provider" does not include a mere provider of services to an investment contract, product, or entity (regardless of whether or not the investment contract, product, or entity holds assets of the covered plan).

The Department believes that these clarifications resolve much of the uncertainty raised by commenters about the intended application of the proposal in the context of plan investments. Other than a fiduciary described in paragraph (c)(1)(iii)(A)(*2*), service providers that only provide non-fiduciary administrative, legal or other services to an investment vehicle, even one holding plan assets, are not covered service providers. For example, a recordkeeper servicing a collective investment fund is not a covered service provider to a plan investing in the fund merely because the fund holds plan assets. On the other hand, if that same recordkeeper provides services directly to a covered plan and receives indirect compensation or certain compensation from related parties, then it would be a covered service provider. Its covered status, however, would derive from the services it provides directly to the plan, not to the collective investment fund. A similar analysis would apply to an investment vehicle that does not hold plan assets, such as a registered investment company.

4. Contracts or Arrangements Not Covered by Interim Final Regulation

The Department notes that some contracts or arrangements will fall outside the scope of the final regulation because they do not involve a "covered plan" and a "covered service provider." ERISA nonetheless requires such contracts or arrangements to be "reasonable" in order to satisfy the ERISA section 408(b)(2) statutory exemption. ERISA section 404(a) also obligates plan fiduciaries to obtain and carefully consider information necessary to assess the services to be provided to the plan, the reasonableness of the fees and expenses being paid for such services, and potential conflicts of interest that might affect the quality of the provided services.[9]

5. Initial Disclosure Requirements

a. Overview of Initial Disclosure Requirements; Request for Comments on Format Requirement for Initial Disclosures

The proposed regulation would have required that the terms of the contract or arrangement for services between the covered plan and the covered service provider be in writing and that the writing delineate the specific disclosure obligations of the covered service provider under the regulation. The Department received a number of comments on the requirement that contracts and arrangements, as well as the disclosure obligations thereunder, must be in writing. Many commenters argued that such written documents are not used with respect to the provision of many services and that requiring formal written contracts adds complexity and costs, as well as potentially raising concerns under State contract law, without affecting the quality of such services. For example, these points were made by providers of insurance products and services, who explained that any amendments to their contracts, which are approved and regulated by State insurance agencies, would have to be submitted to such agencies; this would be a lengthy and burdensome process with an outcome that is not within the service providers' control.

While the interim final rule continues to require that the responsible plan fiduciary be furnished the required disclosures in writing, the rule does not require that a formal contract or arrangement itself be in writing or that any representations concerning the

[9] *See, e.g.,* Field Assistance Bulletin 2002–3 (November 5, 2002), Advisory Opinion 97–15A (May 22, 1997), Advisory Opinion 97–16A (May 22, 1997), Understanding Retirement Plans Fees and Expenses, (*http://www.dol.gov/ebsa/publications/undrstndgrtrmnt.html.*), and Selection and Monitoring Pension Consultants—Tips for Plan Fiduciaries, (*http://www.dol.gov/ebsa/newsroom/fs053105.html.*)

specific obligations of the service provider be included in such written contract or arrangement. The Department is persuaded that, given the varying relationships between plans and their service providers, requiring such a formal contract or arrangement in every instance may result in unnecessary burdens, complexity, and costs. The Department continues to believe, however, that setting forth a covered service provider's disclosure obligations under the regulation in writing generally will help ensure that both the responsible plan fiduciary and the service provider clearly understand their respective responsibilities for purposes of compliance with the statutory exemption.

As discussed above, neither the proposal nor the interim final rule requires the covered service provider to make disclosures in any particular manner or format. Further, the preamble to the proposal specifically noted that the covered service provider could disclose using different documents from separate sources as long as the documents, collectively, contained all of the required information. Commenters on the proposal disagreed as to whether or not this would lead to an effective presentation to responsible plan fiduciaries, especially those for small plans. Commenters also disagreed as to the anticipated costs and burdens associated with more stringent format requirements and the extent to which those costs would be absorbed by service providers or passed through to plans, and therefore potentially to participants and beneficiaries. Some commenters encouraged the Department to retain its flexible approach, arguing that it is best left to the parties to service contracts or arrangements to determine the optimal way to fulfill the substantive disclosure requirements. Other commenters encouraged the Department to adopt a model form for disclosure or to otherwise mandate that the required information be conveyed in a summary or consolidated fashion, arguing that this would lead to more consistency in the way that information is disclosed and make it easier for responsible plan fiduciaries to review and analyze information received from plan service providers.

At this time, the Department has not determined whether it is feasible, as part of this regulation, to provide specific and meaningful standards for the format in which the required information must be disclosed, given the large variety of plan service arrangements that are covered by the interim final regulation and the variation in the way service providers currently disclose information to plan fiduciaries. The Department is persuaded that plan fiduciaries may benefit from increased uniformity in the way that information is presented to them. However, the Department does not want to unnecessarily increase the cost and burden for service providers to furnish required information, especially to the extent such cost may be passed along to plan participants and beneficiaries, unless it is clear that the benefit to plan fiduciaries outweighs such cost and burden. If the Department is convinced that the benefits would outweigh the costs, the final regulation may be revised. Specifically, the Department is considering adding a requirement that covered service providers furnish a "summary" disclosure statement, for example limited to one or two pages, that would include key information intended to provide an overview for the responsible plan fiduciary of the information required to be disclosed. The summary also would be required to include a roadmap for the plan fiduciary describing where to find the more detailed elements of the disclosures required by the regulation.

To assist the Department in its decision whether to include such a requirement in the final rule, interested persons are encouraged to submit comments on three issues: first, the likely cost and burden to covered service providers, and to any other parties, of complying with such a requirement; second, the anticipated benefits to responsible plan fiduciaries, whether due to time savings, cost savings, or other factors, of including a summary disclosure statement; and third, how to most effectively construct the requirement for a summary disclosure statement to ensure both its feasibility and its usefulness in helping the Department achieve its objectives.

As to the substance of the information required to be disclosed, the proposal generally required the disclosure of information intended to assist plan fiduciaries in understanding the services that will be furnished and in assessing the reasonableness of the compensation, direct and indirect, that the service provider would receive in connection with the provision of such services. The proposal also required the disclosure of specific information intended to assist plan fiduciaries in assessing any real or potential conflicts of interest that may affect the quality of the services to be provided. As discussed above, the proposal did not require that the information be furnished in any particular format. While the proposal did require that the required disclosures be furnished in advance of entering into a contract or arrangement, along with a representation that all of the required disclosures had been furnished to the responsible fiduciary, the proposal did not designate any specific time period for making such advance disclosure.

The proposal broadly defined compensation or fees [10] to include money and any other thing of monetary value received by the service provider or its affiliates in connection with the services provided to the plan or the financial products in which assets are invested. As noted, the proposal required the disclosure of both direct and indirect compensation, the latter including fees that the service provider receives from parties other than the plan, the plan sponsor, or the service provider. Service providers also would have been required to disclose compensation received by their affiliates from third parties. The proposal also addressed the manner in which compensation could be disclosed, permitting the use of formulas, references to a percentage of the plan's assets, or per capita charges.

With regard to the disclosure of compensation generally, the proposal contained a special rule for providers of multiple services (commonly referred to as "bundles" of services). In the case of bundled service arrangements, the proposal required only that the provider of the bundle make the prescribed disclosures. In such instances, the bundled service provider would be required to disclose information concerning all of the services to be provided in the bundle, regardless of who actually performs the service. Further, the bundled provider would be required to disclose the aggregate direct compensation that will be paid for the bundle, as well as all indirect compensation that will be received by the service provider, or its affiliates or subcontractors within the bundle, from third parties. The preamble explained that generally the bundled provider would be required to break down the aggregate compensation among the individual services comprising the bundle only when the compensation was separately charged against the plan's investment (such as management fees and 12b–1 fees) or was set on a

[10] For ease of reference, the interim final regulation refers only to "compensation" and not "compensation or fees" or "compensation and fees." Given the broad definition of "compensation" contained in the final regulation, the Department does not intend any substantive distinction by changing from the phrase "compensation or fees" or "compensation and fees" to the term "compensation."

transaction basis (such as finder's fees and brokerage commissions).

While the Department retained many of the disclosure concepts of the proposal, the interim final rule contains a number of changes made in response to issues raised by commenters. Paragraph (c)(1)(iv) of the final rule describes the initial disclosure requirements that must be satisfied, in writing, by the covered service provider; paragraph (c)(1)(v) describes the timing requirements applicable to the initial disclosures and when changes to the initial disclosures must be furnished; paragraph (c)(1)(vi) describes the requirement that a covered service provider disclose information requested by the responsible plan fiduciary or covered plan administrator to comply with ERISA's reporting and disclosure requirements; and paragraph (c)(1)(vii) addresses inadvertent errors and omissions in disclosing the required information.

b. Description of Services

Paragraph (c)(1)(iv)(A) requires a description of the services to be provided to the covered plan pursuant to the contract or arrangement, but not including non-fiduciary services described in paragraph (c)(1)(iii)(D)(*2*). In other words, for purposes of this disclosure, "services" to the covered plan do not include services described in paragraph (c)(1)(iii)(D)(*2*), *e.g.,* services provided by non-fiduciary service providers to investment vehicles holding plan assets. Thus, in the case of a person that is a covered service provider by reason of paragraph (c)(1)(iii)(A)(*2*), paragraph (c)(1)(iv) would require a description of services provided as a fiduciary to the investment vehicle that holds plan assets and in which the covered plan has a direct equity investment.

Some commenters requested guidance as to the level of detail necessary when describing the services. For example, commenters asked whether general descriptions of the services would be acceptable, or whether detailed and itemized descriptions must be provided. It is the view of the Department that the level of detail required to adequately describe the services to be provided pursuant to a contract or arrangement will vary depending on the needs of the responsible plan fiduciary.

In certain instances, it may be well understood that a particular service necessarily encompasses, among other things, a variety of sub-services such that a description of the sub-services is unnecessary. For example, plan fiduciaries may understand that the execution of securities transactions includes, but is not limited to, valuation, safekeeping, posting of income, clearing and settling transactions, and reporting transactions, thereby eliminating the need to describe such sub-services. In an effort to clarify the flexibility inherent in this disclosure requirement, the final rule omits the word "all" from the required description of services.

Ultimately, though, the responsible plan fiduciary must, under sections 404 and 408(b)(2) of ERISA, decide whether it has enough information about the services to be provided pursuant to the contract or arrangement to determine whether the cost of such services to the plan is reasonable. Accordingly, if a particular description of services provided by a covered service provider lacks sufficient detail to enable the responsible plan fiduciary to determine whether the compensation to be received for such services is reasonable, the responsible plan fiduciary must request additional information concerning those services.

There is one provision of the interim final rule that includes a more specific standard for the level of detail that must be furnished when describing the provision of recordkeeping services in specified circumstances. See section (c)(1)(iv)(D)(*2*), discussed below.

c. Status of Covered Service Providers, Affiliates, and Subcontractors

Paragraph (c)(1)(iv)(B) of the regulation requires, 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 vehicle that holds plan assets and in which the covered plan has a direct equity investment) as a fiduciary; 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 Advisers Act or any State law. Thus, if a service provider will, or reasonably expects to, provide services as both a fiduciary and a registered investment adviser, the statement must reflect both of these roles. While the proposal contained a similar disclosure requirement, the requirement contained in the final rule reflects changes that are intended to address concerns raised by commenters.

Commenters on the proposal expressed concern that, given the factual nature of fiduciary status under ERISA, this requirement added a level of uncertainty to the statutory exemption. Commenters also expressed concern that disclosing fiduciary status by virtue of being an investment adviser involved similar uncertainties and, in addition, would only serve to confuse plan fiduciaries regarding the nature of the services that the plan would receive. As discussed above, the Department continues to believe that plan fiduciaries should understand whether a service provider will provide, or reasonably expects to provide, services as an ERISA fiduciary or services as a registered investment adviser in light of their heightened level of responsibility under ERISA and the Advisers Act, respectively. The Department, however, believes that the final disclosure provision addresses the concerns of the commenters. First, the final provision only requires disclosure if the provider will or *reasonably expects* to be providing services as a fiduciary or registered investment adviser. Service providers do not have to indicate that they will not be providing such services. Second, the disclosure with respect to services as an investment adviser is required only for investment advisers who are registered under the Advisers Act or any State law, thereby providing a degree of certainty as to who must make the required disclosure. The final provision does not require investment advisers to identify their services as "fiduciary services."

d. Disclosure of Compensation

The Department received a number of comments on the compensation disclosure requirements of the proposal. Many of the commenters expressed concern about the parties for whom compensation might have to be reported under the proposal, such as providers of services to mutual funds and other investment products in which a plan might invest, and the increased level of complexity attendant to more detailed levels of disclosure generally. The Department believes that many of the issues raised by commenters in this area have been addressed in the final regulation by more specifically defining the parties that would be treated as "covered service providers" for purposes of the disclosure requirements.

The compensation disclosure requirements of the final rule are set forth at paragraph (c)(1)(iv)(C). While structured differently than the proposal, the final rule retains many of the same concepts of the proposal with respect to what types of compensation have to be disclosed for purposes of a reasonable contract or arrangement. The compensation disclosure requirement of the final rule is divided into four subparagraphs to more clearly describe the compensation information that must be disclosed.

Paragraph (c)(1)(iv)(C)(*1*) requires a description of all *direct* compensation, as defined in paragraph (c)(1)(viii)(B)(*1*), 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 described in paragraph (c)(1)(iv)(A). For purposes of the regulation, "direct" compensation is compensation received directly from the covered plan.[11]

This requirement to disclose direct compensation generally follows the requirement of the proposal, with a clarifying change. A number of commenters on the proposal questioned whether the proposal's definition of compensation, which referred to payments received "directly from the plan or plan sponsor" was intended to subject to ERISA section 408(b)(2) payments for services made solely by the plan sponsor and not out of plan assets,. The proposal's reference to payments received from plan sponsors was intended to distinguish direct compensation from indirect compensation. As reflected above, the final regulation omits the reference to the plan sponsor, so as to avoid the confusion raised by commenters. The final rule also clarifies that a covered service provider generally may disclose the direct compensation received from the plan either as a total for all services (*i.e.,* in the aggregate) or on an itemized, service-by-service basis. The Department continues to believe as a general matter that a fiduciary who understands the services the covered service provider is providing pursuant to the contract or arrangement and their aggregate cost is in a position to compare services and costs consistent with its obligations under sections 404 and 408(b)(2) of ERISA, and to determine the reasonableness of compensation paid for such services in the aggregate. There is one exception to this rule, discussed below, for the disclosure of certain compensation received in connection with recordkeeping services. See section (c)(1)(iv)(D) of the final rule.

Finally, in response to the concerns of some commenters about whether a failure to disclose unexpected compensation would result in a prohibited transaction by reason of losing relief under section 408(b)(2), the final rule requires disclosure only of compensation that the service provider, an affiliate, or a subcontractor "reasonably expects" to receive in connection with the services.

Paragraph (c)(1)(iv)(C)(*2*) of the final regulation provides for the disclosure of *indirect* compensation. Specifically, it requires a description of all indirect compensation (as defined in paragraph (c)(1)(viii)(B)(*2*)) that the covered service provider (or an affiliate or a subcontractor) reasonably expects to receive in connection with the services to be provided pursuant to the contract or arrangement. The rule also requires the covered service provider to identify the services for which the indirect compensation will be received and the payer of the indirect compensation. For purposes of the final regulation, "indirect" compensation is compensation received from any source other than the covered plan, the plan sponsor, the covered service provider, an affiliate, or a subcontractor (if the subcontractor receives such compensation in connection with services performed under the subcontractor's contract or arrangement with the covered service provider). See section (c)(1)(viii)(B)(*2*) of the final rule.

The proposal defined compensation or fees as "indirect" if received from any source other than the plan, the plan sponsor, or the covered service provider. The substance of the final rule with regard to disclosure of indirect compensation is similar to the proposed rule, but has been expanded to require disclosure of not only the indirect compensation that a covered service provider expects to receive, as proposed, but also identification of the services for which the indirect compensation will be received and identification of the payer of the indirect compensation.

Paragraph (c)(1)(iv)(C)(*3*) of the final rule provides specific guidance for when compensation paid among related parties, *i.e.,* among the covered service provider, its affiliates, and subcontractors, must be disclosed. The covered service provider must separately disclose such compensation 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). The final rule also requires the covered service provider to identify the services for which such compensation will be paid, the payers and recipients of such compensation, and the status of each payer or recipient as an affiliate or a subcontractor. Under this paragraph (c)(1)(iv)(C)(*3*) of the final rule, compensation must be disclosed regardless of whether such compensation also is disclosed under paragraph (c)(1)(iv)(C)(*1*) or (*2*) (direct and indirect compensation) or (c)(1)(iv)(F) or (G) (investment disclosures). This provision does not apply to compensation received by an employee from his or her employer on account of work performed by the employee. Unless described in paragraph (c)(1)(iv)(C)(*3*) or elsewhere in the final rule, compensation paid among these related parties need not be disclosed. Such payments affect only how compensation is allocated among the parties and generally do not affect the total costs of services to the plan. Thus, the final rule responds to commenters' concerns that when services are provided by multiple parties and priced as a package, the covered service provider is not required to create an artificial allocation of compensation for services among the parties. However, if compensation is paid among related parties in the specific circumstances described in this paragraph (c)(1)(iv)(C)(*3*), the Department does not consider such compensation to be based on artificial methods, such as would be the case when allocations are driven by bookkeeping, tax, or other considerations of the related parties.

The disclosure of indirect compensation and certain compensation paid among related parties serves two purposes. First, the disclosures are intended to enable plan fiduciaries to better assess the reasonableness of the compensation paid for services to the plan by taking into account all of the compensation being received in connection with such services. Second, the disclosures are intended to enable plan fiduciaries to assess actual or potential conflicts of interest that may impact the quality of services provided to the plan.

The proposed rule required the covered service provider to furnish to plan fiduciaries specific information relating to conflicts of interest (see § 2550.408b–2(c)(1)(iii)(C) through (F), at 72 FR 71005). These provisions would have required disclosure of, among other things, information concerning: whether the service provider expects to participate in any transactions entered into with the plan; material financial relationships with certain parties related to the provision of services to the plan; whether the service provider will be able to unilaterally affect its own compensation

[11] This definition, therefore, excludes from the term "direct" compensation any compensation received from a plan asset vehicle in which the covered plan has a direct equity investment.

in connection with its provision of services; whether the service provider has policies or procedures that address actual or potential conflicts and, if so, an explanation of such policies and procedures.

A number of commenters expressed concern about the scope of the proposal's conflict of interest disclosures and the ultimate usefulness of the information to responsible plan fiduciaries in evaluating potential conflicts. Specifically, commenters asserted that the requirements, as proposed, were too broad, pointing out that having to disclose, in addition to actual conflicts, all potential conflicts, would create a potentially limitless, and therefore extraordinarily burdensome, requirement for service providers. Without a clear definition of what kinds of relationships may constitute a conflict and without knowing what other parties a covered plan may be engaging for other services, commenters argued such disclosure would be nearly impossible. Further, commenters pointed out that service providers likely would over-disclose in order to avoid a prohibited transaction, thus inundating plan fiduciaries with excessive, potentially confusing, and ultimately meaningless information. Commenters also requested additional guidance as to what would be a "material" relationship and argued that ambiguity surrounding this term would lead to inconsistent disclosures among various service providers.

Finally, the proposal required a covered service provider to disclose its ability to affect its own compensation. Commenters pointed out that ERISA's prohibited transaction rules preclude fiduciary service providers from engaging in such activity. They also noted that, to the extent that a service provider is not a fiduciary, exercising such discretion over its compensation likely would constitute a fiduciary act resulting in a separate prohibited transaction.

As an alternative to the disclosure regime of the proposed regulation, some commenters suggested that a better indicator of the existence and significance of a conflict of interest is information about the amounts and sources of compensation that service providers expect to receive in connection with the services provided to the plan. After careful consideration of the comments regarding the proposed requirement for narrative descriptions of conflicts of interest, the Department agrees that the final regulation's more detailed disclosure of compensation arrangements, particularly the additional information concerning the receipt of indirect compensation and compensation paid among related parties, will provide clearer and more meaningful information to the responsible plan fiduciaries about potential conflicts of interest than the narrative description of such conflicts required by the proposal. Accordingly, the final rule does not require the narrative disclosures about potential conflicts that were contained in the proposed regulation. Rather, the final rule requires that in conjunction with the description of the indirect compensation being received by the covered service provider (or an affiliate or subcontractor) in connection with the services provided to the plan, the covered service provider must disclose the services to which the indirect compensation relates and the payer of the compensation. Covered service providers similarly must identify the source and recipient of certain compensation paid among related parties, and the services to which such compensation relates. The Department believes that compliance with these disclosure requirements will ensure that fiduciaries have meaningful information with which to assess potential conflicts of interest on the part of their service providers.

Paragraph (c)(1)(iv)(C)(*4*), also consistent with the proposal, requires the covered service provider to describe 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. This provision, however, has been modified slightly from the proposal in an effort to clarify the requirement. Some commenters on the proposal expressed a general concern that fees and charges associated with contract terminations are not currently disclosed, as well as a specific concern that the proposed regulation was not clear as to whether disclosure of these fees and charges was required. In an effort to eliminate any ambiguity concerning the requirement to disclose such information, the requirement has been set forth in a separate paragraph of the final regulation.

e. Disclosures Regarding Recordkeeping Services

The final rule also includes a requirement concerning specific disclosures for recordkeeping services, which was not included in the proposal. Paragraph (c)(1)(iv)(D) provides that, if recordkeeping services will be provided to the covered plan, the covered service provider must furnish 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. In addition, 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, the covered service provider must furnish a reasonable and good faith estimate of the cost to the covered plan of such recordkeeping services. The covered service provider must explain the methodology and assumptions used to prepare the estimate and describe in detail 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.

The addition of this provision to the final rule reflects the Department's belief that information relating to recordkeeping services and the costs to covered plans of those services should be disclosed to responsible plan fiduciaries in a meaningful way. The availability of information sufficient to enable the plan fiduciary to make informed decisions about the costs of recordkeeping is fundamental to a responsible plan fiduciary's ability to satisfy its ERISA obligations. Especially in complicated service arrangements when a variety of services, including recordkeeping services, are provided to the covered plan and may be paid for through charges at the plan investment level or through revenue sharing, it is sometimes difficult for a plan fiduciary to determine the portion of aggregate charges that will be applied to recordkeeping services. The Department believes that requiring such information to be separately disclosed will better enable fiduciaries to make informed evaluations of a covered plan's recordkeeping costs. To the extent recordkeeping costs will not be covered by relatively straightforward direct or indirect compensation received by plan service providers, and to accommodate industry variation in how recordkeeping costs are otherwise absorbed by plan service providers and investment-level charges, the Department included a standard for estimating recordkeeping costs in paragraph (c)(1)(iv)(D)(*2*). A covered service provider cannot avoid providing an estimate required by paragraph (c)(1)(iv)(D)(*2*) merely by disclosing a de minimis amount of direct or indirect compensation for recordkeeping under paragraph (c)(1)(iv)(D)(*1*) when such amount has no relationship to the cost of such services. In such instances, a covered service provider would be required under the final rule to provide an estimate pursuant to paragraph (c)(1)(iv)(D)(*2*) to reasonably reflect the cost to the covered plan of recordkeeping services. The Department believes these estimates, which must be reasonable and made in good faith by the covered service provider, will help responsible plan fiduciaries compare recordkeeping costs among a variety of service providers and service arrangements.

f. Manner of Receipt of Compensation

Paragraph (c)(1)(iv)(E) of the final rule, consistent with the proposal, requires a description of the manner in which the compensation described in paragraphs (c)(1)(iv)(C) and (D) 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.

g. Investment Disclosure—Fiduciary Services and Recordkeeping and Brokerage Services

The definition of compensation under the proposal was very broad and encompassed not only the compensation and fees received by service providers, but also compensation attendant to plan investments and investment options. Disclosures concerning investment-related compensation (*i.e.,* investment management and similar fees charged against investment returns) are particularly significant in that they typically constitute a large portion of the total expenses incurred by a plan and its participants. These disclosures may directly impact the cost of plan services as a result of revenue sharing and similar arrangements between the issuer of a particular investment product and plan service providers. Understanding the fees and expenses attendant to plan investments is particularly significant for fiduciaries of individual account plans that permit participant and beneficiaries to direct their own investments, because it is those fiduciaries who ultimately select the plan's investment options and upon whom the participants and beneficiaries depend to make informed choices concerning their investments. Because investment-related fees and expenses can dramatically reduce the retirement savings of participants and beneficiaries, plan fiduciaries must carefully assess investment fees and expenses, among other factors, in selecting investment options to be made available in participant-directed individual account plans.

The Department received a number of comments concerning the disclosure of investment-related compensation. Most of the comments focused on what information should be disclosed and by whom it should be disclosed. The final regulation addresses the major issues raised by commenters through changes to the scope of the term "covered service provider." For example, the concerns relating to uncertainty as to whether issuers of investment products, and certain service providers to those issuers or products, are themselves covered service providers for purposes of the regulation have been addressed by clarifying who does not constitute a "covered service provider" in the final rule. See above discussion relating to paragraph (c)(1)(iii)(D) of the final rule. Other comments expressed concern about some of the terminology used in the proposal. For example, one commenter expressed the view that the proposal left unclear whether a component of a charge called an "investment management fee" that actually pays recordkeeping or other non-management costs is required to be separately disclosed. The commenter explained that some service providers construe "revenue sharing" which would be required to be disclosed to include only the items specified in the preamble to the proposal, notwithstanding that there may be components of an expense ratio that actually pay for non-investment management services. Other commenters favorably characterized the proposal's definition of fees and expenses as comprehensive. Again, many of these commenters' concerns are addressed by the revisions reflected in the final rule concerning who does (and who does not) constitute a "covered service provider." The Department also believes that the final rule's requirements, discussed below, establish clear standards as to what information concerning plan investments must be disclosed and by whom such information must be disclosed.

As discussed above, the final rule defines the term "covered service provider" to include fiduciaries to certain investment vehicles holding plan assets (paragraph (c)(1)(iii)(A)(*2*)) and providers of recordkeeping and brokerage services to a participant-directed individual account plan if they make available one or more designated investment alternatives for the covered plan (paragraph (c)(1)(iii)(B)). In addition to imposing an obligation to disclose compensation information concerning the services they provide (*i.e.,* as a fiduciary or as a recordkeeper or broker), the final rule requires these covered service providers to disclose compensation information concerning the investments with respect to which they are a fiduciary or provide recordkeeping or brokerage services pursuant to the contract or arrangement with the covered plan. After careful consideration of all of the comments, the Department concluded that these service providers, because they have a relationship with both the investment vehicles and the covered plan, are in the best position to ensure that responsible plan fiduciaries have the information they need about the investments represented by the covered service provider. These investment-related disclosures are described in paragraphs (c)(1)(iv)(F) and (G) of the final rule and are not limited as to who will receive such investment-related compensation. The Department also notes that ERISA section 404(a) obligates plan fiduciaries who invest in vehicles holding plan assets (paragraph (c)(1)(iii)(A)(*2*)) to consider the effect on the plan's rate of return of fees and expenses associated with that vehicle's underlying investments, including any lower tiered entity in which the plan asset vehicle invests.

Paragraph (c)(1)(iv)(F) sets forth the investment-related disclosure obligations of fiduciaries to investment vehicles holding plan assets. These covered service providers (as described in paragraph (c)(1)(iii)(A)(*2*)) must provide, with respect to each investment contract, product, or entity that holds plan assets and in which the covered plan has a direct equity investment, the following information, unless such information is disclosed to the responsible plan fiduciary by a covered service provider described in paragraph (c)(1)(iii)(B) (recordkeeping and brokerage services): (*i*) 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.,* sales loads, sales charges, deferred sales charges, redemption fees, surrender charges, exchange fees, account fees, and purchase fees); (*ii*) a description of the annual operating expenses (*e.g.,* expense ratio) if the return is not fixed; and (*iii*) a description of any ongoing expenses in addition to annual operating expenses (*e.g.,* wrap fees, mortality and expense fees).

Paragraph (c)(1)(iv)(G) requires disclosure of the same investment-related compensation information described above from recordkeepers and brokers that make available investment alternatives for participant-directed individual account plans. This information must be provided with respect to each designated investment alternative for which recordkeeping or brokerage services will be provided pursuant to the contract or arrangement with the covered plan. Paragraph (c)(1)(viii)(C), discussed below, defines the term "designated investment alternative" for purposes of the final rule.

The Department recognizes that recordkeepers and brokers, unlike fiduciaries to investment vehicles holding plan assets, are not directly involved in the day-to-day management of the investment vehicles they represent, but rather, merely serve as intermediaries between plans and the issuers of these investment vehicles for purposes of furnishing such information; the final rule limits their liability under the regulation for the completeness and accuracy of the disclosed information. Specifically, paragraph (c)(1)(iv)(G)(*2*) of the final rule provides that a covered service provider may comply with this investment-related disclosure requirement if the covered service provider provides to the responsible plan fiduciary current disclosure materials of the issuer of the designated investment alternative that include the information described in this paragraph, provided that such issuer is not an affiliate, the disclosure materials are regulated by a State or federal agency, and the covered service provider does not know that the materials are incomplete or inaccurate.

h. Timing of Initial Disclosure Requirements; Changes

With regard to the timing of the required disclosures, the proposed regulation required that service contracts or arrangements include a representation by the service provider that all required information was provided to the responsible plan fiduciary before the contract or arrangement was entered into. This requirement was intended to ensure that the responsible plan fiduciary had the opportunity to consider all required disclosures before entering into a contract or arrangement with a service provider. The Department did not specify any time frame for this disclosure, believing it was best left to the responsible plan fiduciary and its potential service providers to work out the amount of time, prior to entering into the contract or arrangement, that the responsible plan fiduciary would need to review the disclosures. Some commenters suggested that the final regulation provide a more specific timeframe for the disclosures. However, the Department continues to believe that the flexibility described in the proposed regulation is appropriate and that the parties to the contract or arrangement can determine what is reasonable; accordingly, the Department did not adopt the suggestion.

Consistent with the proposal, the final rule, at paragraph (c)(1)(v), requires that a covered service provider provide the initial disclosures required by paragraph (c)(1)(iv), discussed above, to the responsible plan fiduciary reasonably in advance of the date the contract or arrangement is entered into, extended or renewed. The final rule, however, contains an exception for certain persons who become covered service providers within the meaning of paragraph (c)(1)(iii)(A)(*2*) of the final rule subsequent to a plan's investment in an investment vehicle. This situation would arise when a plan invests in an investment vehicle that, at the time of the plan's investment, does not hold plan assets, but that subsequently, for reasons such as another plan's investment in the vehicle, is determined to hold plan assets, thereby causing a fiduciary to such vehicle to be a covered service provider pursuant to paragraph (c)(1)(iii)(A)(*2*). To accommodate such instances, the final rule provides that such a fiduciary service provider must disclose the information required by paragraph (c)(1)(iv) as soon as practicable, but not later than 30 days from the date on which the service provider knows that such investment contract, product or entity holds plan assets.

The final rule also includes a special timing provision for disclosure related to recordkeeping and brokerage services pursuant to paragraph (c)(1)(iv)(G). Information described in paragraph (c)(1)(iv)(G) relating to any investment alternative that is not designated at the time the contract or arrangement is entered into must be disclosed as soon as practicable, but not later than the date on which the investment alternative is designated by the responsible plan fiduciary.

In addition to requiring that certain information be disclosed to responsible plan fiduciaries before the parties enter into, or extend or renew, a contract or arrangement, the proposal included an ongoing obligation for the service provider to disclose to the responsible plan fiduciary any material change to the required information not later than 30 days from the date on which the service provider acquired knowledge of the change. A number of commenters requested additional guidance on what would be considered a "material" change. Some of the commenters' concerns related to the potential breadth of disclosures required by the proposal, with commenters expressing concern as to whether 30 days would provide sufficient time to identify material changes, especially in the context of packaged or bundled services that may involve parties other than the contracting service provider. Some commenters, especially large institutions with multiple affiliations, argued that 30 days was not enough time to discover changes to information relating to all of their business units or affiliates. Commenters also asserted that this requirement would result in voluminous, costly, and inefficient monitoring of disclosures, as well as potential "over-disclosure" of all changes to the extent it is not clear whether a particular change is material. Finally, commenters argued that disputes may result between various parties as to the beginning date for the 30-day compliance period, which may be subjective. Commenters suggested alternative approaches, for example defining materiality for this purpose, extending the 30-day period, or requiring an annual updating of all information in lieu of periodic disclosure of material changes. In response to these comments, the Department has made a number of changes.

Specifically, paragraph (c)(1)(v)(B) of the final rule requires that a covered service provider disclose a change (as opposed to a "material" change) to the initial information required to be disclosed pursuant to paragraphs (c)(1)(iv) 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. The Department was persuaded by commenters' concerns that it may take more than 30 days to accurately identify and disclose changes to information that previously was disclosed, especially in the context of large institutions with multiple affiliates. However, the Department does not believe that a covered service provider should have an unlimited period of time to disclose changes to the responsible plan fiduciary; a certain level of timeliness and efficiency is expected in the marketplace, and covered service providers should be in a position to ensure that the information they disclose to responsible plan fiduciaries about the services they are providing and the compensation they are receiving continues to be accurate. Therefore, disclosure of changes must be made as soon as practicable, but not later than 60 days from the date on which the covered service provider knows 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.

The Department also eliminated the concept of materiality, persuaded by commenters that, without more specific definition, this standard would not add to a covered service provider's understanding of what types of changes must be disclosed. Accordingly, if information previously disclosed to a responsible plan fiduciary changes, the responsible plan fiduciary must be notified. The Department believes that a responsible plan fiduciary should be made aware if any change occurs, for example, in the services that the covered service provider will be providing for the plan, the fiduciary status of the service provider, or the compensation that the service provider will be paid.[12]

i. Reporting and Disclosure Information; Timing

Paragraph (c)(1)(vi) of the final rule addresses the obligations of the covered service provider to provide, upon request of the responsible plan fiduciary or plan administrator, 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. This provision is very similar to the proposal. A few commenters asked the Department to provide that only "reasonable" requests from the responsible plan fiduciary or plan administrator must be accommodated under this provision. The Department did not include this concept in the final rule, because it did not want to create issues as to the "reasonableness" of a particular request. The Department believes that the final rule minimizes the potential for abuse by restricting covered service provider's disclosure obligation to information that is "required" for the covered plan to comply with its reporting and disclosure obligations. Commenters also requested guidance from the Department that the responsible plan fiduciary or plan administrator may not request that this information be disclosed or presented in any particular format. The Department expects that the covered service provider will furnish the information in a manner that enables effective use of the information to satisfy ERISA's Title I reporting and disclosure requirements; no further obligation should be inferred from this requirement.

Finally, a few commenters asked that the Department clarify that this disclosure obligation was limited to information specifically required by a responsible plan fiduciary or plan administrator to complete a Form 5500 annual report. The Department declined to accept this suggestion; the Department expects that this provision will require service providers to disclose information that is necessary in order to comply with ERISA's reporting and disclosure obligations in circumstances other than the Form 5500 annual report, for example in making required disclosures concerning plan and investment fees and expenses to participants and beneficiaries. The Department notes that this is not a limitless obligation; the rule limits this provision to information relating to the contract or arrangement, and the compensation received thereunder, that is "required" for the covered plan to comply with the reporting and disclosure obligations of Title I.

The proposal required that the service provider disclose information requested by the responsible plan fiduciary or plan administrator in order to comply with ERISA's reporting and disclosure obligations, but did not specify any time frame for the service provider to respond to such a request. Some commenters requested additional guidance concerning when the covered service provider would be obligated to provide such information. In response, the Department added a new timing requirement in paragraph (c)(1)(vi)(B) of the final rule. A covered service provider must disclose the requested information not later than 30 days following receipt of a written request from the responsible plan fiduciary or covered plan administrator, 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. The Department believes that this provision will provide more specificity to the parties in complying with this disclosure requirement, but also accommodate the practical reality that a covered service provider may, because of extraordinary matters beyond its control, be unable to satisfy the general standard.

j. Disclosure Errors

The proposed regulation did not provide specific relief for disclosure errors or omissions by service providers. As a result, many commenters argued that the final regulation should be revised to include such relief for service providers in certain circumstances. Many commenters argued that inadvertent mistakes are inevitable, in spite of the best efforts of all involved, and that it would be inappropriate for a service provider to be subject to a prohibited transaction in these circumstances. These commenters believed that, under the proposal, a prohibited transaction would result if any error, no matter how small, existed in the detailed disclosures required by the rule. Commenters felt this risk was especially significant in the case of a package of services involving multiple service providers. These commenters asserted that, with required information coming from different, and in some cases unrelated, parties, the likelihood of "innocent" mistakes increases. Commenters were not comforted by the proposal's limitation that information must be provided "to the best of the service provider's knowledge," because in some cases, such as a typographical error, the service provider may "know" that the information is inaccurate. Further, commenters argued that these errors would not be covered by the material change provision in the proposal, because many minor errors would not be material. Finally, commenters noted that the material

[12] Nothing in the final rule or this preamble relieves a service provider from other obligations or limitations under ERISA, for example other prohibited transactions or, in the case of service providers that are ERISA fiduciaries, the restrictions of ERISA sections 404 or 406(b). *See, e.g.,* Advisory Opinion 97–16A (May 22, 1997) (the Department stated that, in the context of a service provider who retains some authority over the investment options selected by plans by deleting or substituting, in its own discretion, certain unrelated mutual funds, a plan fiduciary must be provided advance notice of the change, including disclosure of fee information, and must be afforded a reasonable amount of time in which to accept or reject the change).

change provision focused on disclosing information when changes occur during the term of the contract and not on information that was incorrect at the time the contract was entered into. Commenters proposed various solutions, such as providing a cure period to allow for correction of minor or inadvertent errors or, alternatively, revising the rule to require only "reasonable" or "good faith" compliance with its disclosure obligations. Other commenters suggested that a correction mechanism could be permitted through the Department's Voluntary Fiduciary Correction (VFC) Program [13] or that relief could be provided through an expansion of the proposed class exemption.

The Department was persuaded by commenters that relief should be provided so that certain inadvertent errors and omissions do not result in a prohibited transaction. Accordingly, paragraph (c)(1)(vii) of the final rule provides that no contract or arrangement will fail to be reasonable under the regulation solely because the covered service provider, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the information required by the regulation. However, the covered service provider must disclose the correct information 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.

The Department notes that the class exemption, included as part of this regulation (paragraph (c)(1)(ix)), is meant to address situations in which a responsible plan fiduciary discovers an error or other deficiency in the disclosure. Paragraph (c)(1)(vii) is meant to provide the parties an opportunity to avoid a prohibited transaction by addressing errors up front. Once a prohibited transaction has occurred, the responsible plan fiduciary will need to rely on the relief provided by the class exemption, discussed below.

6. Definitions

Paragraph (c)(1)(viii) of the final rule defines the terms "affiliate," "compensation," "designated investment alternative," "recordkeeping services," "responsible plan fiduciary," and "subcontractor."

Specifically, paragraph (c)(1)(viii)(A) provides that 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. The rule also provides that unless otherwise specified, an "affiliate" in paragraph (c)(1) refers to an affiliate of the covered service provider. This definition essentially is unchanged from the proposal, except that the definition no longer includes the concept of an "agent" of the covered service provider. The Department was persuaded by commenters that the notion of an "agent" of the covered service provider is unclear, overly broad, and not consistent with commonly understood "affiliate" arrangements. To the extent some commenters were concerned that this term might pull subcontractors of a covered service provider into affiliated status, the Department notes that the final rule specifically addresses the role of a covered service provider's subcontractors elsewhere.

Paragraph (c)(1)(viii)(B) defines "compensation" for purposes of the final rule as anything of monetary value (such as 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. This is slightly different from the proposal, which did not include the $250 de minimis rule. The Department added this provision in response to suggestions from a number of comments concerning the cost and burden of tracking insignificant non-monetary gifts.

The definition of "compensation" includes descriptions of both "direct" and "indirect" compensation. Subparagraph (*1*) defines "direct" compensation as compensation received directly from the covered plan. Subparagraph (*2*) defines "indirect" compensation as compensation received from any source other than the covered plan, the plan sponsor, the covered service provider, an affiliate, or a subcontractor, if the subcontractor receives such compensation in connection with services performed under the subcontractor's contract or arrangement described in the definition of subcontractor contained in paragraph (c)(1)(viii)(F).

Subparagraph (*3*) provides that, for purposes of the regulation, a description or an estimate of compensation 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 cannot reasonably be expressed in such terms, by any other reasonable method.[14] In this regard, any description or estimate must contain sufficient information to permit evaluation of the reasonableness of the compensation. This provision is slightly modified from the proposal, because the final rule also provides that when compensation cannot reasonably be expressed in terms of amounts, formulae or percentages, any other reasonable method may be used (subject to the general requirement that the description of compensation must contain sufficient information to permit evaluation of the reasonableness of such compensation). This standard was modified in part in response to commenters' concern that some types of compensation could not necessarily be expressed in a monetary amount, formula, percentage of the plan's assets, or a per capita charge. The Department continues to prefer disclosure in terms of a monetary amount, formula, percentage of the plan's assets, or a per capita charge; however, the Department is persuaded that in situations when it is not feasible to disclose compensation in such terms, covered service providers should be able to use another reasonable method to do so.

Paragraph (c)(1)(viii)(C) defines a "designated investment alternative" as any investment alternative designated by a fiduciary into which participants and beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts. The term "designated investment alternative" does not include brokerage windows, self-directed brokerage accounts, or similar plan arrangements that enable participants and beneficiaries to select investments beyond those specifically designated. This definition is consistent with the definition used by the Department for purposes of defining "designated investment alternative" in its proposed participant-level fee disclosure regulation (see proposed § 2550.404a–5(h)(1), 73 FR 43041).

Paragraph (c)(1)(viii)(D) defines "recordkeeping services" as including services related to plan administration and monitoring of plan and participant and beneficiary transactions such as enrollment, payroll deductions and

[13] *See* Voluntary Fiduciary Correction Program Under the Employee Retirement Income Security Act of 1974, Adoption of Updated Program, 71 FR 20262 (April 19, 2006).

[14] Some commenters raised concerns with language in the preamble to the proposed regulation which seemed to imply that formulas, percentages, or per capita charges could be used only if it was not possible to disclose in terms of a monetary amount. The Department did not intend this interpretation; as stated in the final rule, there are alternatively acceptable formats for disclosing compensation to a responsible plan fiduciary, so long as the description sufficiently permits evaluation of the reasonableness of such compensation.

contributions, offering designated investment alternatives and other covered plan investments, loans, withdrawals and distributions. It also provides that "recordkeeping services" includes the maintenance of covered plan and participant and beneficiary accounts, records, and statements. This broad definition of recordkeeping is intended to provide basic parameters to ensure that providers of recordkeeping services understand when they will be covered by paragraph (c)(1)(iii)(B) when they also make designated investment alternatives available to the covered plan.

Paragraph (c)(1)(viii)(E) defines a "responsible plan fiduciary" as a fiduciary with authority to cause the covered plan to enter into, or extend or renew, the contact or arrangement. This is consistent with use of the phrase "responsible plan fiduciary" in the Department's proposal, except that for ease of reference it has been separately included in the definitions section.

Paragraph (c)(1)(viii)(F) defines a "subcontractor" as 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 one or more services described in paragraph (c)(1)(iii)(A) through (C) of the regulation provided for by the contract or arrangement with the covered plan. The Department added this concept to the final rule in order to clarify that, in certain instances, a covered service provider will be required to report compensation received by a subcontractor to the covered service provider or an affiliate. For example, if a "covered service provider" that contracts with a plan to provide recordkeeping in turn subcontracts to outsource all or part of those services to another party, then that party is a "subcontractor," because it is carrying out some or all of the covered service provider's obligations under the contract or arrangement with the covered plan. In certain cases, the covered service provider may have to disclose compensation received by this subcontractor.

C. Class Exemption

The class exemption from the restrictions of ERISA section 406(a)(1)(C) was proposed by the Department separately from the proposed regulation. It was intended to relieve a responsible plan fiduciary from engaging in a prohibited transaction under certain circumstances when the requirements of the regulation have not been met. The Department received five separate public comments in response to the invitation for comments contained in the notice of pendency relating to the proposed class exemption, in addition to comments that were made as part of information received from the public on the proposed regulation. This section discusses these comments and modifications that have been made to the final class exemption, which now is being granted and included as section (c)(1)(ix) of the final rule.

1. Comments on Proposed Class Exemption

A few commenters requested that the proposed class exemption be expanded to protect service providers from potential excise taxes under the Code. Specifically, these commenters wanted the class exemption to cover service providers that are responsible for making the rule's required disclosures in certain circumstances: For example, when disclosure is made on behalf of a third party, and the service provider, acting as a conduit, either does not receive the requested information from the third party, or it is later discovered that the information received from the third party was erroneous; when an inadvertent error is made in providing the responsible plan fiduciary with the detailed information required by the proposal, for example, some of the narrative information about conflicts of interest, commenters argued, was vaguely described or overly broad; or when a responsible plan fiduciary fails to execute a service contract or arrangement. The Department has determined not to extend specific prohibited transaction exemption relief from the prohibitions of section 406(a) to covered service providers in the same way that the final class exemption covers responsible plan fiduciaries who attempt to address a service provider's disclosure failure. However, the Department notes that the final rule clarifies that execution of a formal "contract" is not required, and gives covered service providers more opportunities to address disclosure failures, such as errors and omissions. The final rule also provides covered service providers with relief for "passing through" certain regulated disclosure materials that include information concerning plan-designated investment alternatives.

One commenter suggested that the proposed class exemption be expanded to cover prohibited transactions described under section 406(a)(1)(D) of ERISA. Section 406(a)(1)(D) prohibits the transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan. The commenter stated that if the statutory exemption under section 408(b)(2) is temporarily unavailable for a particular service arrangement, but the covered service provider continues to be engaged by the plan to provide necessary services and receives payments, section 406(a)(1)(D) would be violated if plan assets are used to compensate the covered service provider during such time. The Department modified the operative language of the final class exemption to provide relief from section 406(a)(1)(D) to cover, among other things, situations when a responsible plan fiduciary decides to continue a service arrangement with a covered service provider, and to continue paying such covered service provider's fees, during periods when the parties are attempting to cure a disclosure failure by the covered service provider pursuant to the conditions of this exemption.

Other commenters observed that the proposed class exemption would apply if the responsible plan fiduciary unknowingly enters into a service contract that does not satisfy the disclosure obligations of the regulation, provided that certain conditions are met. The proposal required the responsible plan fiduciary to request the missing information, in writing, from the service provider, and the covered service provider would have been deemed to have failed to satisfy its disclosure obligations if it did not provide the information requested by the responsible plan fiduciary within 90 days. In this regard, the commenters requested that a satisfactory and timely service provider response to the 90-day request be deemed to satisfy the disclosure requirements and that the proposed class exemption be revised to provide relief in such instances. One commenter stated that a service provider should not be treated as failing to comply with a responsible plan fiduciary's request for information, for purposes of the exemption, merely because the covered service provider is unable to complete a response within 90 days of the request, despite good faith efforts on the part of the service provider to obtain such information.

The Department has determined that, under the exemption, a responsible plan fiduciary should not be permitted to give a covered service provider an unlimited amount of time to address a disclosure failure. Like the proposal, the final exemption requires that disclosure failures be addressed by the parties within specific timeframes. Under the final exemption, if the covered service provider fails to comply with a responsible plan fiduciary's written request within 90 days of the date of that request, the fiduciary must notify the Department of the service provider's disclosure failure within a specified time period (*i.e.,* 30 days). At such time, the responsible plan fiduciary will be covered by the exemption. The covered service provider will continue to be engaging in a non-exempt prohibited transaction until such time as the service arrangement is terminated or the disclosure failure is cured. Once a service provider's disclosure failure has been cured and the contract or arrangement complies with all of the other conditions of the Department's regulations at 29 CFR 2550.408b–2, or the contract or arrangement is terminated, it is the view of the Department that the prohibited transaction will cease. Thus, covered service providers will not be liable for excise taxes under Code section 4975 for any period following the date on which the disclosure failure is cured or the contract or arrangement is terminated.

Further, some commenters requested that the Department extend the proposed 30-day time period for a responsible plan fiduciary to notify the Department of a covered service provider's failure to disclose. One commenter argued that many plan fiduciary committees do not meet on a monthly basis, and it may be difficult for responsible plan fiduciaries to make final determinations about retention of covered service providers within a 30-day period. The Department did not extend this time period in the final class exemption, which continues to require that notice to the Department be made not later than 30 days following the earlier of the covered service provider's refusal to furnish the requested information or end of the 90-day period following the responsible plan fiduciary's written request.

Finally, one commenter suggested that the exemption should only require responsible plan fiduciaries to notify the Department of a disclosure failure in specific instances, such as when a disclosure failure is made by plan service providers who are ERISA fiduciaries, or when the disclosure failure relates specifically to information about a service provider's fees or other compensation. This approach has not been adopted. The Department believes that all disclosures required under the final regulation by all covered service providers are relevant for purposes of a responsible plan fiduciary's duty to provide notice to the Department of a service provider's failure to correct or address such failures in a timely fashion.

2. Description of the Final Class Exemption

The class exemption is set forth in the final regulation in paragraph (c)(1)(ix). The Department incorporated the exemptive relief into the final regulation in order to facilitate reference by interested persons. The specific conditions applicable to covered transactions are described in this paragraph. These conditions require, among other things, a responsible plan fiduciary to notify the Department under certain circumstances of a covered service provider's failure to comply with its disclosure obligations. These conditions also set forth the timing, content and other requirements applicable to the notice required to be filed with the Department by the responsible plan fiduciary.[15]

The exemption provides relief from the restrictions of section 406(a)(1)(C) and (D) of ERISA to a responsible plan fiduciary, notwithstanding any failure by a covered service provider to comply with its disclosure obligations, provided that the conditions set forth in paragraph (c)(1)(ix)(A) through (G) are met.

Paragraph (c)(1)(ix)(A) of the regulation requires that the responsible plan 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 by the final rule. This condition is intended to reinforce the principle that the plan fiduciary must have entered into, and thereafter continued, an arrangement for services with a reasonable belief that the covered service provider met, and would continue to meet, the requirements of the final rule and without knowing of the covered service provider's disclosure failures.

Paragraph (c)(1)(ix)(B) of the regulation requires that, upon discovering that the covered service provider failed to disclose the required information, the responsible plan fiduciary must request in writing that the covered service provider furnish such information. If the covered service provider fails to comply with the responsible plan fiduciary's written request within 90 days, paragraph (c)(1)(ix)(C) requires that the responsible plan fiduciary notify the Department. The Department believes that this condition, along with a covered service provider's exposure to excise tax liability under the Code, will provide covered service providers with a sufficient incentive to address disclosure failures within a reasonable time.[16]

Paragraph (c)(1)(ix)(D) through (F) of the regulation sets forth the content, timing, and other requirements applicable to notifying the Department of a covered service provider's failure to meet its disclosure obligations. Paragraph (c)(1)(ix)(D) states that the notice to the Department must contain the following information: (*1*) The name of the covered plan; (*2*) the plan number used for the 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 covered plan.

Paragraph (c)(1)(ix)(E) provides that the responsible plan fiduciary shall file a notice with the Department not later than 30 days following the earlier of: (*1*) the covered service provider's refusal to furnish the requested information; or (*2*) the date which is 90 days after the date the written request referred to in paragraph (c)(1)(ix)(B)(*1*) is made. In this context, a covered service provider's refusal to provide information to the responsible plan fiduciary, following such fiduciary's written request, would constitute a covered service provider's failure to meet its disclosure obligations prior to the end of the 90-day period.

Paragraph (c)(1)(ix)(F) provides that the notice should be sent to the U.S. Department of Labor, Employee Benefits Security Administration, Office of Enforcement, 200 Constitution Ave., NW., Suite 600, Washington, DC 20210. Such a notice may also be sent electronically to: *OE-DelinquentSPnotice@dol.gov*. The Department has developed a sample

[15] As with any exemption from ERISA's prohibited transaction provisions, the party seeking to avail itself of the relief provided by the exemption has the burden of demonstrating compliance with the conditions of the exemption.

[16] The notice requirement does not relieve a plan administrator of the obligation to report a prohibited transaction in accordance with the instructions to the Annual Report Form 5500 Series, without regard to whether the covered service provider furnishes information in response to the fiduciary's request.

notice that will facilitate compliance with the notification requirement; this sample notice will be available on the Department's Web site at: *http://www.dol.gov/ebsa/DelinquentServiceProviderDisclosureNotice.doc.*

Finally, paragraph (c)(1)(ix)(G) of the regulation provides that, following the responsible plan fiduciary's discovery that the covered service provider failed to disclose required information, the fiduciary shall determine whether to terminate or continue the contract or arrangement with such service provider. In making such a determination, the responsible plan fiduciary shall evaluate the nature of the failure, the availability, qualifications and costs of potential replacement service providers, and the covered service provider's response to notification of the failure. However, the provisions contained in paragraph (c)(1)(ix)(G) do not abrogate or supersede the duties imposed upon a responsible plan fiduciary by section 404(a) of ERISA, which would also require the fiduciary to consider what steps to take in response to the covered service provider's nondisclosure.

D. Preemption of State Law

Paragraph (c)(1)(x) of the regulation states that the regulation does not supersede any State law that governs disclosures by parties that provide services to covered plans, except to the extent that such law prevents application of the regulation. The Department understands that the service provider relationship with the plan may be subject to a variety of State laws, such as contract, tax, consumer protection, and other laws. The Department's regulation is not intended to supersede any of these State laws, which may require disclosures by parties that provide services described in the regulation, except to the extent that compliance with such State law would make compliance with this regulation impossible or would otherwise conflict with one of the regulation's protections.

Paragraph (c)(1)(x) of the regulation addresses only the preemptive effect of the regulation itself, and does not speak to any preemptive effect that ERISA Title I generally, or ERISA section 514 specifically, may have on State laws that regulate parties that provide services to employee benefit plans. A State law that requires disclosures in connection with services or service provider contract or arrangements, regardless of whether the services are provided directly to an ERISA plan or other entity, generally would not be viewed by the Department as "relating to" employee benefit plans within the meaning of ERISA section 514 or as otherwise preempted by Title I of ERISA.

E. Application of Section 4975 of the Internal Revenue Code

Code section 4975(d)(2) contains a provision that is parallel to ERISA section 408(b)(2). Several commenters questioned the interplay of the proposal and section 4975 of the Code. These commenters explained that this interplay was unclear, because the proposal did not explicitly include corresponding amendments to the regulations under Code section 4975. Commenters generally sought clarification in this regard, asserting their belief that the Department has authority to issue guidance under Code section 4975(d)(2) and should confirm that compliance with the regulation will be required for a covered service provider to avoid the excise taxes imposed by Code section 4975.

The Department added paragraph (c)(1)(xi) of the interim final regulation to clarify this issue. This paragraph provides that, in accordance with the transfer of authority of the Secretary of the Treasury to promulgate regulations of the type published herein to the Secretary of Labor, pursuant to section 102 of the Reorganization Plan No. 4 of 1978, 5 U.S.C. App. 214 (2000 ed.), which was effective December 31, 1978, under the final regulation, all references to section 408(b)(2) of the ERISA and the regulations thereunder should be read to include reference to the parallel provisions of section 4975(d)(2) of the Code and the regulations thereunder.

If a covered service provider to a covered plan fails to disclose the information required by the final rule, then the contract or arrangement will not be "reasonable." Therefore, the service contract or arrangement will not qualify for the relief from ERISA's prohibited transaction rules provided by section 408(b)(2). The resulting prohibited transaction will have consequences for both the responsible plan fiduciary and the service provider. The responsible plan fiduciary, by causing the transaction, will have violated ERISA section 406(a)(1)(C) and (D). The service provider, as a "disqualified person" under the Code's prohibited transaction rules, will be subject to the excise taxes that result from the service provider's participation in a prohibited transaction under Code section 4975.[17]

The Department continues to believe that the application of an excise tax will provide incentives for all parties to service contracts or arrangements to cooperate in exchanging the disclosures required by the final regulation. However, as noted above, the Department does not believe that an otherwise diligent plan fiduciary should be penalized as a result of a failure on the part of service provider to make the required disclosure, thus the final regulation includes the exemptive relief described above (see paragraph (c)(1)(ix) of the interim final rule).

F. Effective Date

Many commenters expressed concern with the Department's proposal that the final regulation and class exemption would be effective 90 days after their publication in the **Federal Register**. Commenters suggested that these effective dates should be extended to as much as 12 months or longer following publication to allow service providers sufficient time re-negotiate with their clients, to make appropriate amendments to their service contracts and disclosure materials, and to make other necessary changes to their business practices, for example, revising any recordkeeping or other systems to ensure that the appropriate information is captured. Otherwise, commenters stated, there may be many compliance failures in the first year following the effective date of the regulation and class exemption. Commenters also suggested that the Department clarify whether the rule's disclosure obligations will apply only to contracts entered into (or extended or renewed) after the effective date of the final regulation.

In response to these concerns, the Department revised the date by which the interim final rule will apply to the disclosures required for a compliant contract or arrangement. Specifically, the rule will be effective one year after the date of its publication in the **Federal Register**. This modification is intended to accommodate concerns raised by commenters as to the cost and burden associated with transitioning current and future service contracts or arrangements to satisfy the requirements of the interim final rule. As of the effective date, all contracts or arrangements for services that fall within the scope of the interim final rule must comply with the interim final rule. Thus, the disclosures for new contracts or arrangements that are entered into on or after the effective date must satisfy the rule. In addition, contracts or arrangements that were entered into prior to that date must comply with the rule as of the effective date. The Department believes that interested persons will have sufficient

[17] The Code also includes rules relating to statutory relief applicable to transactions between a plan and a service provider. *See generally* Code section 4975.

time to address the requirements of the interim final rule and establish procedures to ensure compliance with both the regulation and, if necessary, the class exemption.

G. Welfare Plan Disclosure—Reserved

As explained above in the section entitled "Scope—Covered Plans," the Department is reserving paragraph (c)(2) of the interim final rule for a comprehensive disclosure framework applicable to "reasonable" contracts or arrangements for welfare plans to be developed by the Department. The Department believes that fiduciaries and service providers to welfare benefit plans would benefit from regulatory guidance in this area for the same reasons that apply to defined contribution plans and defined benefit plans. However, the Department is persuaded that there are significant differences between service and compensation arrangements of welfare plans and those involving pension plans and that the Department should develop separate, and more specifically tailored, disclosure requirements under ERISA section 408(b)(2) for welfare benefit plans.

H. Existing Requirement Concerning Termination of Contract or Arrangement

The Department did not propose any changes to the existing requirements addressing termination of contracts or arrangements for purposes of section 408(b)(2) (*see* 29 CFR 2550.408b–2(c)); however, the Department did invite comments from the public as to any issues relating to this requirement. In response to this invitation, one commenter suggested that the Department more definitively delineate time frames for service contracts or notice provisions, for example, by requiring that contracts be no more than one year in length or requiring at least 60 days notice for termination. The Department did not accept this suggestion, because the Department believes that such specific judgments are best left to the responsible plan fiduciaries contracting for services to ascertain the most appropriate term for their contracts and an appropriate notice period for termination. An acceptable time frame in one set of circumstances would not necessarily work in another, and the Department does not believe a mandate in this context is appropriate.

Other commenters raised questions as to whether certain fees and market value adjustments, generally associated with insurance or insurance-type services and investments, constitute "penalties" for purposes of this paragraph of the regulation. The regulation provides specifically that "a minimal fee in a service contract which is charged to allow recoupment of reasonable start-up costs is not a penalty." The Department believes that questions as to whether, for any particular contract, the charges for contract termination are in fact "penalties," rather than a service provider's recoupment of reasonable start-up costs, are inherently factual questions; accordingly, the Department did not amend the rule in response to these comments. After consideration of all of the comments on paragraph (c)(2) of the proposal, the Department has determined to adopt that paragraph, without change, in the interim final rule, except that this provision has been moved to a new paragraph (c)(3) of the interim final rule.

I. Effect on Other Statutory and Administrative Exemptions

A number of commenters requested clarification of the effect of the Department's proposed regulation on statutory and administrative exemptions that already are in place. Comments on these issues were received from industry groups that represent banks, insurance companies and broker-dealers for securities and other financial instruments, as well as from financial institutions. According to the commenters, the affected financial firms provide services to all types of plans, including many large plans, and that prohibited transaction issues are raised not only with service arrangements but with specific financial transactions occurring in the ordinary course of their business. These transactions often require reliance upon one or more prohibited transaction exemptions, some of which are periodically amended to reflect current industry practices. Commenters generally did not address how the proposal would affect plan service arrangements that rely on existing statutory exemptions. However, a few commenters asserted that they would not be subject to the disclosure requirements under the regulation because they are relying on other statutory exemptions to avoid prohibited transactions under ERISA section 406.

The Department is expressing no view at this time on the relationship of this interim final rule to existing statutory and administrative exemptions. The Department will, however, be reviewing these issues in the future on a case-by-case and exemption-by-exemption basis.

J. Justification for Interim Final Rulemaking; Request for Comments

Following the Department's careful review of the extensive public record on this regulatory initiative, including over 100 comments on the proposal and many supplemental materials furnished in connection with the Department's public hearing on this initiative, the regulation published today in this Notice contains a number of provisions that differ significantly from the proposal. The Department believes that this regulation addresses the many technical concerns raised with respect to the proposal and clarifies with sufficient specificity the nature of the required disclosure obligations and the parties that must comply with such obligations. However, in view of the importance of this initiative, and the potentially significant effects that the final regulation and class exemption may have on plan fiduciaries and service providers, the Department decided to publish this regulation as an interim final regulation.

The Department invites comments from interested persons on all aspects of the interim final regulation, in accordance with the instructions for submitting comments described above in the **ADDRESSES** section of this Notice.

K. Regulatory Impact Analysis

1. Background

Compensation arrangements in the market for retirement plan services are complex. Payments from third parties and among service providers can create conflicts of interest between providers and their clients. For example, a 401(k) plan vendor may receive "revenue sharing" from a mutual fund that it makes available to clients. A consultant may receive a "finder's fee" from an investment adviser it recommends to clients. Such compensation arrangements and the conflicts they create are myriad and largely hidden from view. Their opacity obscures the true cost of plan services and allows harmful conflicts to persist in the market. Plans may pay more than they realize for products and services that unbeknownst to them are tainted by conflicts. Meanwhile service providers may reap excess profits.

Under ERISA, fiduciaries have a duty to consider a service provider's compensation from all sources, but service providers are not obligated to disclose compensation from other sources. This interim final rule would require service providers to proactively disclose such arrangements to plan clients.

2. The Need for Regulatory Action

To the extent that plan fiduciaries are unable to obtain relevant compensation information, or unable to use it to choose among service providers in a manner that upholds their fiduciary duty, a failure exists in the market for services for employee benefit plans. The market for retirement plan services is characterized by acute information asymmetry. The information costs of plan service providers are far lower than their clients'. Vendors are specialists in the design of their products, services, and compensation arrangements, and are continually engaged in marketing to plan sponsors. Plan sponsors often lack this degree of specialization. Even very large, relatively sophisticated plan sponsors shop for services only periodically, generally once every three to five years. Smaller, less sophisticated plan sponsors face still higher information costs. As a result, vendors are able to maintain an information advantage over their plan sponsor clients.

Vendors have a strong incentive to use their information advantage to distort market outcomes in their own favor. Current ERISA rules hold plan sponsors rather than vendors accountable for evaluating the cost and quality of plan services. And vendors can reap excess profit by concealing indirect compensation (and attendant conflicts of interest) from clients, thereby making their prices appear lower and their product quality higher. Consider one typical arrangement: A pension consultant receives a finder's fee from an investment adviser when he recommends that adviser to a plan sponsor. The plan sponsor does not know that the consultant is receiving the finder's fee—an expense the plan bears indirectly. The plan sponsor relies on the consultant to evaluate the quality of the adviser's services, but does not know that the consultant's recommendation and evaluation are subject to a conflict of interest.

The Department has identified evidence that information gaps exist in certain circumstances and that these gaps may distort market results. For example:

- An Advisory Council established under ERISA to advise the Secretary of Labor found that "the lack of transparency in this area has led to an inefficient market where it is extremely difficult for the plan sponsor to determine either the absolute level of fees, or the flow of fees, *i.e.,* who is getting paid what." [18]
- The Securities and Exchange Commission found that pension consultants "typically" do not disclose to clients that they receive compensation from the same money managers that they may recommend, and recommended that pension consultants adopt "policies and procedures to ensure that all disclosures required to fulfill fiduciary obligations are provided to prospective and existing advisory clients, particularly regarding material conflicts of interest [which should] ensure adequate disclosure regarding the consultant's compensation." [19]
- According to GAO, "[s]pecific fees that are 'hidden' may mask the existence of a conflict of interest * * * If the plan sponsors do not know that a third party is receiving these fees, they cannot monitor them, evaluate the worthiness of the compensation in view of services rendered, and take action as needed." [20] GAO found that defined benefit (DB) pension plans using consultants with SEC-identified undisclosed conflicts earned returns 130 basis points lower than the others.[21] GAO recommended that Congress "consider amending ERISA to explicitly require that 401(k) service providers disclose to plan sponsors the compensation that providers receive from other service providers." [22]
- Many DC retirement plan sponsors have "difficulty" obtaining a clear understanding of total administrative fees charged (13 percent), a clear explanation of the normal fund operating expenses of the funds in the plan (9 percent), a clear description of all the revenue sharing arrangements that the recordkeeper has with the mutual funds included in the plan (13 percent), and what it costs the provider to administer the plan (20 percent).[23] Many are "dissatisfied" with the degree to which fees are transparent (18 percent) and the degree to which revenue sharing is disclosed (22 percent); 23 percent feel that their retirement plan provider(s)' current level of fee disclosure does not meet their needs as a plan sponsor.[24] While most fiduciaries may think they have all the information they need, there could be information they are lacking and are not aware of. This disclosure will make sure fiduciaries are receiving the information the Department believes they need to fulfill their fiduciary duty under ERISA.
- One comment [25] received by DOL on the proposed 408(b)(2) regulation notes "the difficulty that plan sponsors encounter in the defined contribution plan marketplace in obtaining comparable information on the charges to be incurred for the same or similar services." Another commented that "Sponsors * * * must expend significant time and effort comparing fees among providers because of varying formats and service models as well as unique fee structures associated with different investment vehicles. By moving toward a more uniform standard of fee disclosure, the Department's initiative * * * will reduce the time and effort spent by plan sponsors assembling and comparing price information, and * * * will help facilitate apples-to-apples comparisons of different service models and investment products." A third commenter stated that "plan expense and fee information is often scattered, difficult to access, or nonexistent * * * Plan fiduciaries should know whether their plan's service providers have potential conflicts of interest."

Under current rules, a large, sophisticated plan sponsor may be able to uncover adequate information to optimize his purchase, if the value he expects to reap is sufficient to offset his information cost. The sophisticated plan sponsor's cost to uncover the information is likely to be far higher than would be the vendor's cost to disclose it. A smaller or less sophisticated plan sponsor cannot economically uncover such information—the value he stands to gain will not offset his information cost. A regulatory action to mandate proactive disclosure will lower information costs for plan sponsors who currently actively seek this information. In addition, to the extent the information provided is

[18] *See e.g.,* ERISA Advisory Council on Employee Welfare and Pension Benefit Plans, *Report of The Working Group on Plan Fees and Reporting on Form 5500* (Nov. 10, 2004), *at http://www.dol.gov/ebsa/publications/AC_111804_report.html.*

[19] *See e.g.,* U.S. Securities and Exchange Commission, Office of Compliance Inspections and Examinations, *Staff Report Concerning Examinations of Select Pension Consultants* (May 2005).

[20] *See e.g.,* GAO, *Increased Reliance on 401(k) Plans Calls for Better Information on Fees,* Private Pensions Report (March 6, 2007), *at http://www.gao.gov/new.items/d07530t.pdf.*

[21] *See e.g.,* GAO, *Conflicts of Interest Involving High Risk of Terminated Plans Pose Enforcement Challenges,* Defined Benefit Pension Report (June 2007), *at http://www.gao.gov/new.items/d07703.pdf.*

[22] *See e.g.,* GAO, *Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information on Fees,* Private Pensions Report (Nov. 2006), *at http://www.gao.gov/new.items/d0721.pdf.*

[23] *See e.g.,* Deloitte, *401(k) Benchmarking Survey 2008 Edition.*

[24] *See e.g.,* Chatham Partners, *Looking Beneath the Surface: Plan Sponsor Perspectives on Fee Disclosure* (February 2008).

[25] Public comments on the proposed rule may be found at: *http://www.dol.gov/ebsa/regs/cmt-408(b)(2)-combined.html.*

readily usable the disclosure will help facilitate more informed, optimal purchases.

3. Executive Order 12866 Statement

Under Executive Order 12866, the Department must determine whether a regulatory action is "significant" and, therefore, subject to the requirements of the Executive Order and review by the Office of Management and Budget (OMB). Under section 3(f) of the Executive Order, a "significant regulatory action" is an action that is likely to result in a rule (1) Having an effect on the economy of $100 million or more in any one year, or adversely and materially affecting a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local or tribal governments or communities (also referred to as "economically significant"); (2) creating serious inconsistency or otherwise interfering with an action taken or planned by another agency; (3) materially altering the budgetary impacts of entitlement grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) raising novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in the Executive Order. The Department has determined that this action is "economically significant" under section 3(f)(1) because it is likely to have an effect on the economy of $100 million or more in any one year.

4. Regulatory Alternatives

Executive Order 12866 requires an economically significant regulation to include an assessment of the costs and benefits of potentially effective and reasonably feasible alternatives to a planned regulation, and an explanation of why the planned regulatory action is preferable to the identified potential alternatives. The Department considered but rejected a number of alternative approaches to correct the market failure and redress abuses.

Covering Welfare Benefit Plans: The Department considered applying the interim final rule to welfare benefit plans, because it believes fiduciaries and service providers to such plans would benefit from regulatory guidance in this area. However, the Department is persuaded, based on the public comment and hearing testimony, that there are significant differences between service and compensation arrangements of welfare plans and those involving pension plans and that the Department should develop separate, and more specifically tailored, disclosure requirements under ERISA section 408(b)(2) for welfare benefit plans. Accordingly, the interim final rule includes a new paragraph (c)(2), which has been reserved for a comprehensive disclosure framework applicable to "reasonable" contracts or arrangements for welfare plans to be developed by the Department.

Covering IRAs: The IRA and employment-based retirement plan markets are very different from one another. In the IRA market, decisions are made by consumers rather than plan sponsors acting in a fiduciary capacity, and the disclosures appropriate for the latter may not be appropriate for the former.

More Extensive Disclosure: Applying disclosure requirements to arrangements where compensation is less than $1,000, requiring a comprehensive line-item breakdown of the price of bundled services, or requiring disclosures to be part of formal written contracts might not produce benefits that would justify the associated cost.

Directing Mandate at Fiduciaries: A mandate directed solely at fiduciaries would diverge little from current law. Such a mandate would merely create a brighter line of obligation for the fiduciary without empowering him to satisfy that obligation; perpetuate the information asymmetry, therefore not correcting the market failure; and would not equip the Department to redress service provider abuses.

Requiring Disclosure only on Demand: Requiring disclosure only on demand rather than proactively might correct the current market failure and equip the Department to redress abuse. However, disclosure-on-demand would have serious unintended adverse consequences, particularly for plan fiduciaries:

- Once fiduciaries are legally empowered to obtain full disclosure of indirect compensation arrangements, failure to do so would almost certainly constitute a fiduciary breach. This sets a trap for the unwary fiduciary. The unsophisticated fiduciary is better served by a proactive disclosure that serves as both a notice of his duty and a means to discharge his obligation.
- The cost of disclosure-on-demand could turn out to be higher than the cost of proactive disclosure. For example, it would now include the cost to plan sponsors of making the requests—as well as their cost of determining what to ask. Also the number of disclosures might be higher under a disclosure-on-demand system than under a proactive disclosure system. All fiduciaries would have a duty to request disclosure, so perhaps nearly all would, and many fiduciaries might ask in increments for information that would have been consolidated into a single proactive disclosure under a proactive disclosure system, therefore multiplying the total number of disclosures. The Department has not developed a cost estimate for disclosure-on-demand, but it is likely that such an estimate would be as high as, or higher than, the Department's estimate for proactive disclosure.
- Disclosure-on-demand would also fail to educate unsophisticated fiduciaries who might not request full disclosure. Proactive disclosure might raise awareness for some unsophisticated fiduciaries.

Requiring a Summary Disclosure: The Department is persuaded that plan fiduciaries may benefit from increased uniformity in the way that information is presented to them. The Department considered adding a requirement that covered service providers furnish a "summary" disclosure statement, for example limited to one or two pages, that would include key information intended to provide an overview for the responsible plan fiduciary of the information required to be disclosed. The summary also would be required to include a roadmap for the plan fiduciary describing where to find the more detailed elements of the disclosures required by the regulation. However, the Department did not implement this requirement as part of the interim final rule, because it did not want to unnecessarily increase the cost and burden for service providers to furnish required information, especially to the extent such cost may be passed along to plan participants and beneficiaries, unless it is clear that the benefit to plan fiduciaries outweighs such cost and burden.

As stated earlier in this preamble, the Department is considering amending the rule in the future to include a summary disclosure requirement. To assist the Department in its decision regarding whether to include such a requirement in the final rule, interested persons are encouraged to submit comments regarding the potential costs and time burden necessary for covered service providers, and any other parties, to comply with such a requirement, the anticipated benefits to responsible plan fiduciaries of including a summary disclosure requirement (such as time and cost savings), and how to most effectively design a summary disclosure statement to ensure both its feasibility and usefulness in helping the Department achieve its objectives. If the Department is convinced that the benefits would outweigh the costs, the final regulation may be revised.

Chosen Alternative: The Department considered, and ultimately has adopted, a rule requiring that, in order for a contract or arrangement to be reasonable, certain categories of service providers must disclose specified information to responsible plan fiduciaries. The rule generally covers typical plan service providers including fiduciary service providers and providers furnishing accounting, actuarial, appraisal, auditing, banking, consulting, custodial, insurance, investment advisory, legal, recordkeeping, securities or other investment brokerage, third party administration, or valuation services. The Department believes this framework will yield the information that plan fiduciaries need in order to assess the reasonableness of compensation paid for services from these service providers and their potential conflicts of interest. Absent the regulation, such information may be difficult to obtain. The Department believes that the interim final rule provides the largest benefit among the alternatives, while also limiting costs.

5. Affected Entities and Other Assumptions

According to 2006 Form 5500 filings, there exist nearly 49,000 defined benefit pension plans with over 42 million participants and almost 646,000 defined contribution pension plans with approximately 80 million participants. Out of these pension plans, about 37,000 are small defined benefit plans and 576,000 small individual account plans.[26] Most of the pension plans, approximately 462,000, are participant directed individual account plans.

The interim final regulation applies to contracts or arrangements between plan fiduciaries and service providers as fully discussed in Section B., 1., above.[27] In order to estimate the number of covered service providers and the number of service provider-plan arrangements, the Department has used data from plan year 2006 submissions of the Form 5500 and its Schedule C.

In general, only plans with 100 or more participants that have made payments to a service provider of at least $5,000 are required to file the Form 5500 Schedule C. These plans are also required to report the type of services provided by each service provider. The Department counted the service providers most likely to provide the covered services.[28] In total, there were nearly 9,900 unique covered service providers reported in the Form 5500 Schedule C data, almost 1,000 of which reported receiving $1 million or more in compensation.

The Department acknowledges that this estimate may be imprecise. On the one hand, some of these service providers may not be covered service providers if they do not meet all the above specified requirements, but with the limited Schedule C data it is not possible to further refine this group. On the other hand, small plans generally do not have to fill out Schedule C which would underestimate the number of covered service providers if a substantial number of them service only small plans. However, the Department believes that most small plans use the same service providers as large plans and therefore the estimate based on the Schedule C filings by large plans is acceptable.[29]

Schedule C data was also used to count the number of covered plan-service provider arrangements. On average, defined benefit plans employ more covered service providers per plan than defined contribution plans, and large plans use more covered service providers per plan than small plans. In total, the Department estimates that defined benefit plans have over 119,000 arrangements with covered service providers, while defined contribution plans have over 780,000 arrangements.

A substantial part of the cost of the final regulation depends on the means of disclosures between covered service providers and plan fiduciaries. Paper disclosures involve much higher costs than electronic disclosures. Thus, as at least one trade group commented, the industry is interested in taking advantage of electronic disclosure, if at all possible.[30] This conclusion seems plausible as most covered service providers are sophisticated entities and by the nature of their services are electronically savvy, as are most plan fiduciaries. Unaware of any contrary comments, the Department assumes that about 50 percent of disclosures between service providers and plan fiduciaries are delivered only in electronic format.

6. Benefits

Mandatory proactive disclosure will reduce sponsor information costs, discourage harmful conflicts, and enhance service value. Additional benefits will flow from the Department's enhanced ability to redress abuse. Although the benefits are difficult to quantify, the Department is confident they more than justify the cost. In accordance with OMB Circular A–4,[31] Table 2 below depicts an accounting statement showing the Department's assessment of the benefits and costs associated with this regulatory action.

TABLE 2—ACCOUNTING TABLE

Category	Primary estimate	Year dollar	Discount rate	Period covered
Benefits				
Annualized Monetized ($millions/year)	Not Quantified.			
Qualitative: The final regulation will increase the amount of information that service providers disclose to plan fiduciaries. Non-quantified benefits include information cost savings, discouraging harmful conflicts of interest, service value improvements through improved decisions and value, better enforcement tools to redress abuse, and harmonization with other EBSA rules and programs.				
Costs Annualized Monetized ($millions/year)	58.7	2010	7%	2011–2020

[26] Small pension plans are plans with generally less than 100 participants, as specified in the Form 5500 instructions.

[27] Plan sponsors and/or plan participants may also be indirectly affected.

[28] In order to provide a reasonable estimate, service providers with reported type codes corresponding to contract administrator, administration, brokerage (real estate), brokerage (stocks, bonds, commodities), consulting (general), custodial (securities), insurance agents and brokers, investment management, recordkeeping, trustee (individual), trustee (corporate) and investment evaluations were assumed to provide covered services.

[29] While in general small plans are not required to file a Schedule C, some voluntarily file. Looking at Schedule C filings by small plans, the Department verified that most small plans reporting data on Schedule C used the same group of service providers as larger plans.

[30] *See http://www.dol.gov/ebsa/regs/cmt-408(b)(2)-combined.html.*

[31] *Available at http://www.whitehouse.gov/omb/circulars/a004/a-4.pdf.*

TABLE 2—ACCOUNTING TABLE—Continued

Category	Primary estimate	Year dollar	Discount rate	Period covered
	54.3	2010	3%	2011–2020
Qualitative: Costs include costs for service providers to perform compliance review and implementation, for disclosure of general, investment-related, and additional requested information, for responsible plan fiduciaries to request additional information from service providers to comply with the exemption and to prepare notices to DOL if the service provider fails to comply with the request.				
Transfers	Not Applicable.			

a. Information Cost Savings

The record establishing the need for this regulatory action (see above) documents that plan sponsors' information cost is higher than vendors', and that many sponsors now expend substantial resources to acquire information. Mandatory proactive disclosure will make the information fiduciaries need available to them at lower acquisition cost.

For sponsors in these circumstances, mandatory, proactive, comprehensive disclosure will reduce the difficulty in obtaining the needed information. These sponsors will have the same information as before but will acquire it less expensively. For example, if 13 percent [32] of estimated 695,000 pension plans had a plan fiduciary that experienced a one hour drop in the time needed to obtain the needed information at an hourly labor rate [33] of $107 the value of time saved annually could be $9.7 million.

b. Acquisition of Critical Information

As discussed above, many surveyed DC retirement plan sponsors are "dissatisfied" with the level of transparency—23 percent flatly say the current level of fee disclosure does not meet their needs. These sponsors will now acquire critical information that was previously inaccessible or too costly to obtain. Currently, some plan sponsors may simply fail to seek critical information. Mandatory, proactive disclosure will help these sponsors understand and satisfy their fiduciary obligations. For those who otherwise would not know what questions to ask, or what information to consider, the disclosure provides the map. This additional information will help facilitate better decisions as discussed in the next two sections.

c. Discouraging Harmful Conflicts

Indirect compensation arrangements can be either harmful or beneficial. Transparency will help drive harmful conflicts from the marketplace while sustaining arrangements that are beneficial for plans.

Harmful arrangements generally are those that are tainted by unmitigated conflicts. A plan's service providers may strike deals that profit one another at the plan's expense. Such arrangements may thrive in the shadows, but tend to wither in sunlight. These arrangements exist today in the market for plan services precisely because information asymmetries obscure them. Mandatory proactive disclosure will reduce the asymmetry, creating a sunnier climate that is less friendly to harmful arrangements.

Beneficial arrangements generally are those in which a plan's service providers, in competition to provide the best value to the plan, enter into transactions among themselves that leverage their respective comparative advantages to deliver higher quality or lower cost for the plan. Such arrangements are now evident in the segment of the plan services that works best—namely, the very large plan segment. There are numerous examples where large plan sponsors, after thoroughly evaluating the quality and compensation structures of competing vendors, choose service arrangements that involve indirect compensation. Transparency is a bedrock of such arrangements. For example, some arrangements establish formulas whereby the fees the sponsor pays to a service provider will be reduced as a function of the indirect compensation the provider receives. Mandatory, proactive disclosure will be friendly to such arrangements because sunlight will reveal their superiority to harmful arrangements.

d. Service Value Improvements

Fiduciaries armed with more complete information can make informed purchases and thereby derive better value for plans. More complete information is a benefit of mandatory disclosure that will depend sequentially on three variables: The extent of gaps in critical information, the extent to which closing these gaps will improve fiduciary decisions, and the degree to which improved decisions will improve value.

Information Gaps: Plan sponsors need comprehensive information on service provider compensation in order to discharge their fiduciary duty and secure good value for their plans and participants. However, only 57 percent of sponsors report that their service provider discloses revenue sharing agreements and investment offsets with both alliances and their own proprietary funds.[34] About one-quarter of sponsors are not familiar with revenue sharing arrangements between their investment managers and retirement plan providers (26 percent) and compensation arrangements between retirement plan providers and the intermediary involved in the plan (25 percent) (familiarity was lower among sponsors of smaller plans).[35] These findings suggest that gaps in critical information are large and widespread. Some sponsors who lack critical information are aware of the problem and poised to use the information effectively once it is more accessible. Others are less aware, but proactive disclosure will raise awareness for some of these sponsors.

Improved Decisions: To secure better value, fiduciaries must factor newly available critical information appropriately into their purchasing decisions. Eighty-four percent of sponsors say they will use fee related information supplied by their retirement plan provider(s) to fulfill their fiduciary responsibilities. Sixty-four percent say

[32] As discussed above, many surveyed DC retirement plan sponsors (13%) have "difficulty" obtaining key information. This percent is used as a proxy for the percent of plan fiduciaries that would experience time savings from mandatory disclosure. We do not have concrete data regarding whether the plan sponsors obtained the information or the time/resources expended, because the survey did not collect this information. However, ERISA requires fiduciaries to obtain the information.

[33] This estimate uses the average labor rate of a financial manager as a proxy for a plan fiduciary's labor rate.

[34] *See e.g.,* Deloitte, *401(k) Benchmarking Survey 2008 Edition.*

[35] *See e.g.,* Chatham Partners, *Looking Beneath the Surface: Plan Sponsor Perspectives on Fee Disclosure* (2008).

they will use it to examine their existing fee structure. Commonly cited top concerns regarding fee disclosures include that a lack of disclosure causes higher plan expenses (45 percent) and may lead to legal action by participants (46 percent).[36] Eighty-two percent of sponsors are very (55 percent) or somewhat (27 percent) likely to review DC fund expenses and revenue sharing in 2008.[37] These findings suggest that many fiduciaries are prepared to factor newly available information on service provider compensation into their decisions.

Improved Value: The value of decisions fiduciaries make can improve only if the current decisions made produce value that is less than optimal. Research literature provides evidence that the current value of decisions fiduciaries make is often less than optimal, and that the suboptimal value is associated with undisclosed compensation arrangements that may pose conflicts. As noted above, a recent GAO study links undisclosed conflicts with 130 basis points of underperformance in DB plans. Seventeen percent of DC plan sponsors negotiate and receive fee credits for revenue sharing or investment offsets that exceed their service providers' costs.[38] Many others may use this information to negotiate lower direct fee payments. A variety of academic studies further support the hypothesis that conflicts often erode the value provided to DC plans by mutual funds and their distribution channels.[39]

Overall, the evidence suggests that the value of fiduciary decision-making will improve once fiduciaries are apprised of and consider service providers' indirect compensation sources.

While the improvement in the value of fiduciary decision-making is difficult to quantify, the Department believes that it has the potential to be very large. If just 16 percent of all plan assets realize a fall of just 0.6 basis point (0.006 percent of plan assets), the savings would exceed the costs of the rule, which is estimated at $408 million over 10 years.[40] As noted above, substantially more than 10 percent of fiduciaries report difficulty or dissatisfaction with current fee disclosure. At the same time, one basis point is a very small fraction of a typical plan's expenses—for example, according to the Investment Company Institute, more than one-half of 401(k) stock mutual fund assets are in funds with expense ratios between 50 and 100 basis points, nearly one-fourth are in funds with higher expenses.[41] In addition, GAO's study linking undisclosed conflicts with 130 basis points of underperformance suggests that value can be improved via service quality as well as price.[42] Viewed in this context, the Department is confident that the potential for improved value of fiduciary decision-making from mandatory proactive disclosure is substantial.

e. Preventing and Redressing Abuse

As previously stated, the Department believes that the application of an excise tax will provide incentives for all parties to service contracts or arrangements to cooperate in exchanging the disclosures required by the final regulation. However, if there continues to be abusive conduct by rogue service providers such as misrepresentation of compensation arrangements and attendant conflicts, this rule mandating disclosure will equip the Department to better redress such abuse. Enhanced enforcement will deter abuse, thereby directly benefiting potential victims, and will promote confidence and thereby encourage sponsors to offer plans.

The regulation requiring proactive disclosure encourages compliance in three related ways:

• If the service provider fails to provide the specific information required by the regulation, it is subject to the imposition of an excise tax by the Internal Revenue Service. Thus, there is a direct sanction against the service provider for giving false, misleading, or insufficient statements to plan fiduciaries.

• The regulation specifies the disclosure that fiduciaries must obtain to avoid a prohibited transaction, and ensures that they will receive the information because of the consequences to the service provider of non-disclosure (imposition of the excise tax).

• Because the regulation creates a roadmap for disclosure, it will be much easier for the courts, the Department, and regulated parties to determine whether they have complied with the law. In the event of non-compliance, there are clear enforcement consequences for both the plan fiduciary and the service provider.

7. Harmonization With Other Rules and Programs

The Department pursues a comprehensive program of enforcement and compliance assistance (including outreach and education) to ensure that fiduciaries understand and properly discharge their duties under ERISA, at reasonable cost.

• The Department educates plan fiduciaries about their obligations under ERISA by conducting numerous educational and outreach activities, such as a nationwide series of 33 seminars presented to date as part of the Department's campaign entitled "Getting It Right—Know Your Fiduciary Responsibilities," which includes a discussion of the importance of selecting plan service providers and the role of fee and compensation considerations.

• The Department also makes a variety of materials available on its Web site to educate plan fiduciaries about service provider fees and relationships, including its 401(k) Plan Fee Disclosure worksheet, a publication entitled "Understanding Retirement Plan Fees and Expenses," and, in coordination with the Securities and Exchange Commission, a series of tips concerning fees and conflicts of interest for plan fiduciaries to use when selecting pension consultants.

ERISA's standards of fiduciary conduct already obligate fiduciaries to obtain and consider adequate information. They are liable for any plan losses attributable to their failure to do so. This rule harmonizes the prohibited transaction rules with the fiduciary rules, so fiduciaries, in addition to being obligated to obtain and consider such information, are also equipped to do so at minimum cost.

8. Costs

The Department estimated costs for the rule over the ten-year time frame for purposes of this analysis and used information from the quantitative characterization of the service provider market presented above as a basis for these cost estimates. This characterization did not account for all service providers, but it does provide

[36] *See id.*

[37] *See e.g.,* Hewitt, *Hot Topics in Retirement,* 2008.

[38] *See e.g.,* Deloitte, *401(k) Benchmarking Survey 2008 Edition.*

[39] Examples include: Daniel B. Bergstresser et al., Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry, Social Science Research Network Abstract 616981 (Sept. 2007). Mercer Bullard *et al.,* Investor Timing and Fund Distribution Channels, Social Science Research Network Abstract 1070545 (Dec. 2007). Xinge Zhao, The Role of Brokers and Financial Advisors Behind Investment Into Load Funds, China Europe International Business School Working Paper (Dec. 2005), at *http://www.ceibs.edu/faculty/zxinge/brokerrole-zhao.pdf.*

[40] For a more detailed explanation see the discussion in Section 9 "Uncertainty".

[41] Investment Company Institute. Research Fundamentals, Vol. 16, No. 4, September 2007.

[42] GAO report, "Private Pensions: Conflicts of Interest Can Affect Defined Benefit and Defined Contribution Plans", GAO–090–503T, March 24, 2009.

information on the segments of the service provider industry that are likely to be most affected by the rule (*i.e.,* those who service pension plans). In addition to the costs to service providers, the Department also considered, and discusses below, the potential costs to plans.

a. Costs for Service Providers

Compliance Review and Implementation: Most of the cost of the rule will be imposed on plan service providers. Covered service providers will need to review the rule, evaluate whether their current disclosure practices comply with its requirements, and, if not, determine how their disclosure practices must be changed to be compliant. The Department projected this as a cost incurred in 2011, the year in which the rule takes effect.

Although all affected service providers are assumed to incur these initial costs, it is likely that service providers with complex fee arrangements and conflicts of interest would require more time to comply. The Department assumes that the number of service providers with more complex arrangements can be approximated by the number of unique service providers who are reported on the Schedule C as having received $1 million or more in compensation (nearly 1,000 service providers).

The Department assumes that covered service providers with complex arrangements will require on average 24 hours of legal professional time at a cost of approximately $119 per hour and on average 80 hours of financial professional time at a cost of almost $63 per hour to comply with the rule. Non-complex service providers would require only three hours of legal professional time and 13 hours of financial professional time. Using the number of unique service providers identified in the quantitative analysis presented above (nearly 10,000 service providers), this cost is estimated to be about $17.9 million.

The Department also has estimated the initial compliance review and implementation costs for service providers newly entering the market ("new service providers") to provide services to plans (either for the first time or by re-entry) beginning in 2012 and each year thereafter. Based on data from the 2005 and 2006 Form 5500, the Department assumes that about eight percent of all service providers will be new in each year subsequent to 2011, and that these service providers will incur the same compliance review and implementation costs as existing service providers. Based on the foregoing, the Department estimates that new service providers will incur costs of approximately $1.5 million in 2012 and thereafter. Estimates are reported in Table 3.

TABLE 3—COMPLIANCE REVIEW AND IMPLEMENTATION

Year		Number of entities (A)	Legal professional hours required (B)	Hourly labor cost for legal professional (in 2010 dollars) (C)	Financial professional hours required (D)	Hourly labor cost for financial professional (in 2010 dollars) (E)	Yearly undiscounted costs A*(B*C+D*E)
2011	Plans	695,000		$119	1	$63	$43,625,000
	Non-Complex Service Providers.	9,000	3	119	13	63	10,403,000
	Complex Service Providers.	1,000	24	119	80	63	7,511,000
2012	Plans	94,000		119	1	63	5,911,000
	Non-Complex Service Providers.	700	3	119	13	63	867,000
	Complex Service Providers.	100	24	119	80	63	626,000
Total for 2011							61,539,000
Total for 2012							7,404,000

Note: The displayed numbers are rounded to the nearest thousand and therefore may not add up to the totals.

Initial Disclosure: As discussed above, covered service providers also must develop or update their current disclosure materials to comply with the regulatory requirements. Paragraph (c)(1)(iv)(A) through (E) of the rule requires service providers to provide an initial disclosure to a responsible plan fiduciary. Generally, under paragraph (c)(1)(v)(A) of the rule, this disclosure must be made reasonably in advance of when a contract is entered into, extended, or renewed. The Department assumes that service providers will create an initial disclosure that can be used for all plans and customize this document by adding individualized information for each plan. This activity includes developing formulae and algorithms to present or estimate direct and indirect compensation that will be applied in a pro forma projection for each plan with which the provider will contract. It also includes making a reasonable and good faith estimate of the cost to provide recordkeeping services to a covered plan if the covered service provider reasonably expects to provide recordkeeping services without explicit compensation or when compensation for recordkeeping is subject to an offset or rebate for such services as required by paragraph (c)(1)(iv)(D)(*2*). The Department assumes that the majority of this cost would be incurred by service providers in 2011 and that one hour of a legal professional's time and 45 minutes of a financial professional's time will be required to prepare the general disclosure for each plan. Based on the foregoing, the Department estimates that the cost to develop the general disclosure in 2011 will be almost $75 million.

In 2012 and subsequent years, the regulation will cause additional disclosures to be made between covered plans and service providers for any new contracts and arrangements. The Department does not have information on the number of new arrangements in a year; therefore, the Department used the percentage of plans that are new plans, about 14 percent, as a proxy for the percentage of new arrangements in a year. This results in almost 122,000 new arrangements every year. The Department assumes that half of the responsible plan fiduciaries in these arrangements would receive the required information even without the regulation enacted. The Department estimates that preparing the disclosures for new arrangements will require one hour of a legal professional's time and 45 minutes of a financial profession's time. Based on the foregoing, the cost of preparing these disclosures in year 2012 and thereafter will be almost $23 million.

Paragraph (c)(1)(vi) requires service providers to provide any other information relating to 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 upon the request of responsible plan fiduciaries or plan administrators of covered plans. The Department is not aware of a basis for determining the number of requests that responsible plan fiduciaries or plan administrators will make; therefore, it assumes that approximately ten percent (almost 45,000) of responsible plan fiduciaries will request additional information annually. The Department further assumes that service providers will already have this information available, as it is required to comply with other legal requirements. Therefore, the Department estimates that it will take clerical staff two minutes per request at an hourly labor cost of approximately $26 to prepare the information. Based on the foregoing, the Department estimates that the annual cost to disclose information upon request will total almost $39,000 as shown in Table 3.

Paragraph (c)(1)(v)(B) generally requires service providers to disclose any changes to the general information as soon as practicable, but no later than 60 days from the date the covered service provider is informed of such change. The Department assumes that one-half hour of legal professional time and one-third hour of a financial professional time will be required to update the disclosures. The Department also assumes that changes in plan disclosures will occur at least once every three years, because plans normally conduct requests for proposal (RFPs) from service providers at least once every three to five years. If it is assumed that an equal number of plans conduct an RFP in any given year, then approximately 35 percent of arrangements will require an updated disclosure every year. In addition, half of these plans would already have updated the information without the regulation for a total of approximately 157,000 updates to the general information. Based on the foregoing, the Department estimates that the cost of updating the disclosure of general information will total about $13 million a year as shown in Table 4.

In total, the cost of the disclosure of the general information will be almost $75 million in 2011 and almost $23 million in each subsequent year as shown in Table 4.

TABLE 4—DISCLOSURE OF GENERAL INFORMATION

Year	Number of arrangements (A)	Professional hours (B)	Professional hourly labor cost (C)	Professional hours (D)	Total yearly cost A*B*C
2011:					
Initial Disclosure: Legal	450,000	1	$119	450,000	$53,539,000
Initial Disclosure: Financial	450,000	0.75	63	337,000	21,189,000
2012:					
Initial Disclosure: Legal	61,000	1.00	119	61,000	7,254,000
Initial Disclosure: Financial	61,000	0.75	63	46,000	2,871,000
Disclosure of Changes: Legal	157,000	0.50	119	79,000	9,369,000
Disclosure of Changes: Financial	157,000	0.33	63	52,000	3,296,000
All Years:					
Information Upon Request	45,000	0.03	26	1,500	39,000
Total for 2011					74,767,000
Total for 2012					22,830,000

Note: The displayed numbers are rounded to the nearest thousand and therefore may not add up to the totals.

Investment Disclosure: As discussed in section B.,5.,g., above, paragraphs (c)(1)(iv)(F) and (G) generally require fiduciaries of certain investment vehicles holding plan assets (described in paragraph (c)(1)(iii)(A)(*2*)) and providers of recordkeeping and brokerage services to a participant-directed individual account plan (without regard to whether they expect to receive indirect compensation), if they make available one or more designated investment alternatives for the covered plan (described in paragraph (c)(1)(iii)(B) ("platform providers")), to disclose investment-related fee and expense information. This information generally must be disclosed to the responsible plan fiduciary reasonably in advance of the date the contract or arrangement is entered into, extended or renewed.[43] Paragraph (c)(1)(iv)(G)(*2*) allows covered platform providers to satisfy this disclosure requirement by providing current disclosure materials of the issuer of the designated investment alternative to the responsible plan fiduciary that include the required information, provided that the issuer is not an affiliate of the platform provider, the disclosure materials are regulated by a State or Federal agency, and the covered service provider does not know that the materials are incomplete or inaccurate.

The cost of disclosing investment-related compensation information will be attributable primarily to time spent gathering the required information.

[43] Generally, service providers are required to disclose any change to investment-related information as soon as practicable, but not later than 60 days from the date on which the covered service provider is informed of such change.

However, much of this cost will be reduced because, as discussed above, the rule allows platform providers to satisfy this requirement by passing through information to the responsible plan fiduciary. Based on the foregoing, the Department assumes that preparation of investment-related compensation and fee information will require one-half hour of financial professional time for each of the individual account plans. As mentioned above, it is assumed that 50 percent of these disclosures already occur; therefore, the costs for approximately 231,000 disclosures are calculated, resulting in costs of approximately $7.3 million (see Table 5).

In addition, service providers must disclose changes to investment information. The Department assumes that service providers will have to disclose investment information changes to each responsible plan fiduciary at least once per year due to the regulation, resulting in about 200,000 disclosures. This notification is expected to require one-half hour of financial professional time to prepare. Further, it is assumed that 14 percent (over 31,000) of arrangements will be new in a year and require the initial investment disclosure. Based on the foregoing, the Department estimates that reporting the required investment related information in years 2012 and later will cost approximately $7.3 million annually as shown in Table 5.

TABLE 5—PREPARATION OF DISCLOSURE OF INVESTMENT INFORMATION

	Number of plans (A)	Professional hours (B)	Professional hourly labor cost (C)	Total professional hours (D)	Total yearly cost A*B*C
2011 Initial Disclosure	231,000	0.5	$63	116,000	$7,255,000
2012 Initial Disclosure	31,000	0.5	63	116,000	983,000
Disclosure of Changes	200,000	0.5	63	100,000	6,272,000
Total for 2011					7,255,000
Total for 2012					7,255,000

Note: The displayed numbers are rounded to the nearest thousand and therefore may not add up to the totals.

b. Costs to Plans

ERISA requires plan fiduciaries, when selecting or monitoring service providers, to act prudently and solely in the interest of the plan's participants and beneficiaries and for the exclusive purpose of providing benefits and defraying reasonable expenses of administering the plan. Fundamental to a fiduciary's ability to discharge these obligations is the availability of information sufficient to enable the plan fiduciary to make informed decisions about the services, the costs, and the service provider. The rule will assist plan fiduciaries in this area by requiring service providers to make specified complete and accurate disclosures in order to benefit from the section 408(b)(2) statutory exemption.

The Department estimates the responsible plan fiduciaries will need one hour to ensure compliance with the rule; therefore, the cost of the review is expected to be approximately $43.6 million in 2011 as reported in Table 3.

Starting in 2012 and each year thereafter, responsible plan fiduciaries of new plans will have to familiarize themselves with the rule to ensure their compliance . Based on data from the 2005 and 2006 Form 5500, the Department estimates that 14 percent of plans will be new each year. The Department assumes that responsible plan fiduciaries of new plans will have the same costs as fiduciaries of existing plans. Therefore, the cost of the review for fiduciaries of new plans is estimated to be $5.9 million annually for years 2012 and thereafter as shown in Table 2.

c. Cost of Exemption for Responsible Plan Fiduciary

The final class exemption contained in paragraph of (c)(1)(ix) of the rule provides relief from the restrictions of ERISA section 406(a)(1)(C) and (D) for plan fiduciaries that enter into a contract with service providers upon a mistaken belief that they have received all of the disclosures required by the interim final rule. Upon discovering that a covered service provider failed to disclose all of the required information, the responsible plan fiduciary must take reasonable steps to obtain such information, including requesting in writing that the covered service provider furnish the information in order to rely on the exemption and notify the Department if the service provider fails to comply with the written request within 90 days.

While the Department has no basis for estimating the percentage of arrangements where a responsible plan fiduciary will not receive all of the required disclosures from a covered service provider, the Department assumes that 10 percent of arrangements (approximately 69,000) may experience a failure that will require the responsible plan fiduciary to send a notice to the service provider in 2011. In 2012 and thereafter, the number of requests for missing information is expected to decrease to 5 percent of arrangements (about 35,000). The Department estimates that one-half hour of a financial professional's time will be required to prepare the request for the undisclosed information. Table 6 reports the cost of preparing the disclosure to be almost $2.2 million in 2011 and approximately $1.1 million annually in the subsequent years.

TABLE 6—NOTICE TO SERVICE PROVIDERS

Year	Requests for additional information (A)	Hours per request (B)	Hourly labor cost (C)	Total hours (D)	Total cost A*B*C
2011	69,000	0.5	$63	35,000	$2,181,000
2012	35,000	0.5	63	17,000	1,091,000

Note: The displayed numbers are rounded to the nearest thousand and therefore may not add up to the totals.

The Department further assumes that service providers may not respond to 10 percent of the requests for undisclosed information within 90 days, which will result in the responsible plan fiduciary preparing and sending a notice to the Department. The Department estimates that one-half hour of a financial professional's time will be required to prepare the notice. As shown in Table 7 below, almost 7,000 notices will be sent in 2011 at a cost of approximately $218,000, and in the subsequent years, over 3,400 notices will be sent annually at a cost of approximately $109,000.

TABLE 7—NOTICE TO DOL

Year	Number of notices to DOL (A)	Hours per notice (B)	Hourly labor cost (C)	Total hours (D)	Total cost A*B*C
2011	7,000	0.5	$63	3,500	$218,000
2012	3,500	0.5	63	1,700	109,000

Note: The displayed numbers are rounded to the nearest thousand and therefore may not add up to the totals.

d. Paper and Mailing Costs

The Department assumes that clerical staff will prepare all of the required notices and disclosures for distribution and that 50 percent of the disclosures will be sent electronically at no cost. Table 8 displays for each type of disclosure the number of notices that will be sent, the required amount of clerical time, and the annual cost of preparation.

TABLE 8—PREPARATION COSTS

	Number of notices (A)	Percent not sent electronically (B)	Clerical hours (C)	Clerical hourly labor cost (D)	Total cost A*B*C*D
Initial Disclosure: 2011	450,000	50	1/30	$26	$196,000
Initial Disclosure: 2012	61,000	50	1/30	26	27,000
Information Upon Request	45,000	50	1/30	26	20,000
Disclosure of Changes to Initial Disclosure	157,000	50	1/30	26	69,000
Investment Disclosure: 2011 *	231,000	50	17/30	26	1,711,000
Investment Disclosure: 2012 *	31,000	50	17/30	26	232,000
Disclosure of Changes to Investment Disclosure	200,000	50	1/30	26	87,000
Request for Additional Information for Exemption: 2011	69,000	50	1/60	26	15,000
Request for Additional Information for Exemption: 2012	35,000	50	1/60	26	8,000
Prepare Notice to DOL: 2011	7,000	50	1/60	26	1,500
Prepare Notice to DOL: 2012	3,500	50	1/60	26	800

Note: The displayed numbers are rounded to the nearest thousand and therefore may not add up to the totals.
* The estimate assumes 2 minutes per investment to prepare the disclosure. Plans have on average 17 investments.

Table 9 reports the printing and postage costs associated with each required notice and disclosure. The Department assumes that 50 percent of the disclosures will be sent electronically at no cost, and that the cost of printing and paper for the remaining 50 percent of documents is 5 cents per page.

TABLE 9—MAILING COSTS

	Number of notices (A)	Percent not sent electronically (percent) (B)	Pages (C)	Cost per page (D)	Postage (E)	Total costs A*B*(C*D+E)
Initial Disclosure: 2011	450,000	50	8	$0.05	0.44	$189,000
Initial Disclosure: 2012	61,000	50	8	0.05	0.44	26,000
Information Upon Request	45,000	50	10	0.05	0.44	21,000
Disclosure of Changes to Initial Disclosure	157,000	50	4	0.05	0.44	50,000
Investment Disclosure: 2011*	231,000	50	510	0.05	10.35	4,141,000
Investment Disclosure: 2012*	31,000	50	510	0.05	10.35	561,000
Disclosure of Changes to Investment Disclosure	200,000	50	2	0.05	0.44	54,000
Request for Additional Information for Exemption: 2011	69,000	50	2	0.05	0.44	19,000
Request for Additional Information for Exemption: 2012	35,000	50	2	0.05	0.44	9,000
Prepare Notice to DOL: 2011	7,000	50	2	0.05	0.44	2,000
Prepare Notice to DOL: 2012	3,000	50	2	0.05	0.44	1,000

Note: The displayed numbers are rounded to the nearest thousand and therefore may not add up to the totals.
* The number of pages is 17*30, which is the average number of investments in a plan times 30 pages per investment disclosure.

As shown in Table 10, total costs for service providers and plan sponsors add up to about $152.5 million for the year 2011.

TABLE 10—TOTAL DISCOUNTED COSTS OF PROPOSAL

Year	Cost of legal review (A)	Cost of general information disclosure (B)	Cost of investment information disclosure (C)	Cost of qualifying for exemption (D)	Total costs A+B+C+D
2011	$61,539,000	$75,312,000	$13,248,000	$2,437,000	$152,535,000
2012	6,919,000	21,534,000	7,653,000	1,139,000	37,245,000
2013	6,467,000	20,125,000	7,152,000	1,064,000	34,808,000
2014	6,044,000	18,809,000	6,685,000	995,000	32,531,000
2015	5,648,000	17,578,000	6,247,000	929,000	30,403,000
2016	5,279,000	16,428,000	5,839,000	869,000	28,414,000
2017	4,933,000	15,354,000	5,457,000	812,000	26,555,000
2018	4,611,000	14,349,000	5,100,000	759,000	24,818,000
2019	4,309,000	13,410,000	4,766,000	709,000	23,194,000
2020	4,027,000	12,533,000	4,454,000	663,000	21,677,000
Total with 7% Discounting					412,183,000
Total with 3% Discounting					462,827,000

Note: The displayed numbers are rounded to the nearest thousand and therefore may not add up to the totals.

e. Comments and Revisions

The Department received several comments suggesting that it had underestimated the costs of the proposal and questioning various assumptions on which the estimates were based. In response to these comments, the Department increased its estimate of the amount of legal and financial professionals' time service providers would require to become compliant with the regulation. It also reevaluated its estimates of the number of affected service providers. (The Department also revised some of the proposal's provisions in light of these comments to ease compliance burdens, as explained earlier in this preamble.)

In addition to revisions made in response to comments, the Department updated its estimates of service providers, plans, participants, assets and labor costs, as well as its estimates of the preparation, distribution and mailing costs of the required disclosures, to reflect more current data.

f. Summary

In summary, the Department has calculated total costs of approximately $412 million for the ten-year period 2011 to 2020.

9. Uncertainty

The Department's estimates of the effects of this regulation are subject to uncertainty. While the Department is confident that improved fee disclosures can reduce the time fiduciaries spend searching for needed information, discourage harmful conflicts of interest, reduce gaps in information received by plan fiduciaries, improve fiduciary decisions relating to purchases of plan services leading to reduced plan fees and provide better enforcement tools to redress abuses by service providers, it is uncertain about the magnitude of these effects. The uncertainty is attributable to gaps in available data and empirical evidence. Some key areas of uncertainty are elaborated below.

Reduction in fees—By making information more readily available, this regulation may increase the amount of information that is considered, along with the effort devoted to and efficiency of such consideration. This in turn could reduce fees paid to service providers relative to value derived for participants in either or both of two ways. First, fiduciaries might more accurately optimize the levels and types of services purchased, for example by downgrading from a premium service level, whose price exceeds the benefit to participants, to an economy service level whose price is smaller than the benefit. This would represent a gain in welfare equal to the cost savings reduced by any diminishment in benefits attendant to the service downgrade. Second, fiduciaries might identify and take advantage of opportunities to purchase equivalent services at a lower price (or superior services at the same price) from a different vendor. If this savings is attributable to the service being produced more efficiently by the competing vendor it would reflect a welfare gain; if it is attributable to a shifting of existing surplus from the service producers to consumers with no improvement in production efficiency, it would reflect a transfer.

The Department attempted to consider the potential amount by which fees might be reduced. A review of literature on dispersion of mutual fund fee levels and the value of services purchased with such fees suggests that at least some fiduciaries and participants of individual account plans, by making different and more optimal choices about which services to purchase or what vendors to purchase from, might reduce fees by perhaps 11 basis points per year on average.[44] There is evidence for potential savings to defined benefit plans as well. A recent GAO report found that defined benefit plans whose consultants have undisclosed conflicts of interest have between 1.2 and 1.3 percentage points lower rates of return. The report acknowledges that this finding does not

[44] This assumption was developed in light of evidence presented in Brad M. Barber et al., *Out of Sight, Out of Mind, The Effects of Expenses on Mutual Fund Flows,* Journal of Business, Volume 79, Number 6 2095, 2095–2119 (2005); James J. Choi et al., *Why Does the Law of One Price Fail? An Experiment on Index Mutual Funds,* National Bureau of Economic Research Working Paper W12261 (May 2006); Deloitte Financial Advisory Services LLP, *Fees and Revenue Sharing in Defined Contribution Retirement Plans* (Dec. 6, 2007) (unpublished, on file with the Department of Labor); Edwin J. Elton et al., *Are Investors Rational? Choices Among Index Funds,* Social Science Research Network Abstract 340482 (June 2002); and Sarah Holden & Michael Hadley, *The Economics of Providing 401(k) Plans: Services, Fees and Expenses 2006,* Investment Company Institute Research Fundamentals, Volume 16, Number 4 (Sept. 2007). This estimate of excess expense does not take into account less visible expenses such as mutual funds' internal transaction costs (including explicit brokerage commissions and implicit trading costs), which are sometimes larger than funds' expense ratios. *See, e.g.,* Jason Karceski *et al., Portfolio Transactions Costs at U.S. Equity Mutual Funds,* University of Florida Working Paper (2004), *at http://thefloat.typepad.com/the_float/files/2004_zag_study_on_mutual_fund_trading_costs.pdf.*

necessarily imply a causal arrangement, but it references "expert" opinions that such undisclosed conflicts of interest could result in lower returns.[45]

In light of the foregoing evidence, the Department believes it is highly possible that this regulation could fill gaps in critical information, thus improving fiduciary decisions, and will reduce service costs relative to value derived to yield benefits that exceed costs. Table 11 below provides a break-even analysis to illustrate this point. Previously cited studies suggest that perhaps a quarter of sponsors currently lack critical information[46] and as many as 65 percent would use additional information to change existing fee structures.[47] Given the total amount of assets in plans, if the sponsors are able to reduce fees by 0.6 basis point per year on average, the benefits of the mandatory disclosure requirements would exceed the costs. Due to uncertainty about the size of the reduction in fees, and uncertainty about what fraction of the fee reduction would reflect welfare gains, the Department did not include the reduction in fees in its calculation of the benefits of the regulation.

TABLE 11—REDUCTION IN FEES NECESSARY FOR BENEFITS TO EXCEED COSTS (2011)

Total amount of assets in plans (in millions of 2010 dollars) (A)	Percent of sponsors currently lacking critical information (B)	Percent of sponsor who will use the information to change existing fee structures (C)	Total 10–Year compliance costs annualized at 7% (in millions of 2010 dollars) (D)	Percent correction due to disclosure necessary for benefits to exceed costs D/(A*B*C)
$6,390,000	25%	65%	$58.7	0.006%

Other areas of uncertainty—Also subject to substantial uncertainty are the Department's estimates of: The fraction of plan fiduciaries already receiving the required disclosure information (both benefits and costs would vary negatively); the time required for legal professionals, financial professionals and clerical professionals to perform compliance tasks pursuant to the regulation (costs would vary positively); and the extent to which disclosures will be made electronically rather than on paper (costs would vary negatively). In developing its assumptions regarding these and other variables, the Department took into account both relevant comments received on the proposed regulation and differences between the requirements of the proposed and those of the final regulations. The Department believes its assumptions are reasonable and that the uncertainty attendant to them does not cast serious doubt on the Department's conclusion that the regulation's benefits justify its costs.

10. Final Regulatory Flexibility Analysis

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) (RFA) imposes certain requirements with respect to Federal rules that are subject to the notice and comment requirements of section 553(b) of the Administrative Procedure Act (5 U.S.C. 551 *et seq.*) and which are likely to have a significant economic impact on a substantial number of small entities. Unless an agency determines that a proposal is not likely to have a significant economic impact on a substantial number of small entities, section 604 of the RFA requires that the agency present a final regulatory flexibility analysis (FRFA) describing the rule's impact on small entities and explaining how the agency made its decisions with respect to the application of the rule to small entities. Small entities include small businesses, organizations and governmental jurisdictions.

a. Need for and Objectives of the Rule

Service providers to pension plans increasingly have complex compensation arrangements that may present conflicts of interest. Thus, small plan fiduciaries face increasing difficulty in carrying out their duty to assess whether the compensation paid to their service providers is reasonable. As supported by public commenters on the proposal and witnesses at the Department's hearing, this rule is necessary to help such fiduciaries get the information they need to negotiate with and select service providers who offer high quality services at reasonable rates.

b. Public Comments

Public comments on the proposed rule raised a number of issues with respect to its application to and impact on small entities. Several commenters affirmed the Department's view, articulated in the preamble to the proposed rule, that the number of small service providers to plans is large and that the cost of complying with the proposed rule might be proportionately higher for smaller service providers. However, some comments suggested that the Department had underestimated the cost to small service providers to comply with the proposed rule.

Many of the comments expressed uncertainty about the scope of the proposed rule's application, attributing complexity and cost to that uncertainty and to the possibility that the scope might be very broad (for example, that it might encompass a broad array of indirect service providers). The Department has refined the proposed rule to clarify that the interim final rule encompasses only those service providers and compensation arrangements that are likely to require close consideration by plan fiduciaries. Small service providers generally fall within the scope of the interim final rule only if they are plan fiduciaries, provide plan services as a registered investment adviser, provide certain other services directly to a plan and receive indirect compensation in connection with such services, or provide an investment platform through which investment options are made available to participants and beneficiaries in participant-directed individual account plans. A potentially large number of small, indirect service providers will not be subject to the interim final rule, even if they perform services for a plan under subcontract to another (direct) service provider. The Department lacks data on how many such indirect service arrangements exist, because such arrangements are not required to be identified in plans' annual reports.

Some comments suggested that the cost of rigorous disclosure is not

[45] *See Conflicts of Interest Involving High Risk or Terminated Plans Pose Enforcement Challenges,* U.S. Government Accountability Office (June 2007).

[46] *See e.g.,* Chatham Partners, *Looking Beneath the Surface: Plan Sponsor Perspectives on Fee Disclosure* (2008).

[47] *See e.g.,* Hewitt, *Hot Topics in Retirement,* 2008.

justified in the case of very small service arrangements. The interim final rule generally excepts from its requirements contracts or arrangements where compensation or fees are less than $1,000. It is likely that a large number of small service provider arrangements fall into this category. Some portion of compliance costs, including the most recurring costs (as opposed to start-up costs), are variable: they grow with the number of covered arrangements the service provider maintains. Therefore, this exception will be especially helpful to small service providers whose business consists of a large number of small contracts or arrangements, which will be excepted from coverage if they result in less than $1,000 in compensation or fees.

Some comments stated that many arrangements are not established under a formal contract and that requiring all arrangements to be so established would be costly. The Department believes such a requirement might be disproportionately costly for small service providers, whose arrangements might be small relative to the partially fixed cost of entering into a contract and who might lack in-house expertise in contract law. The interim final rule includes no such requirement, but instead allows all required disclosures to be provided by other means so long as they are provided in writing.

c. Affected Small Entities

The Department estimates that the interim final rule will apply to approximately 9,600 small service providers (generally, those with revenue less than $6.5 million per year). These service providers generally consist of professional service enterprises that provide a wide range of services to plans, such as investment management or advisory services for plans or plan participants, and accounting, auditing, actuarial, appraisal, banking, consulting, custodial, insurance, legal, recordkeeping, brokerage, administration, or valuation services. Many of these service providers have special education, training, and/or formal credentials in fields such as ERISA and benefits administration, employee compensation, taxation, actuarial science, law, accounting, or finance.

d. Compliance Requirements

The classes of small service providers subject to the interim final rule includes service providers who are plan fiduciaries (for example who manage plan investments), who provide services as registered investment advisers to plans, who receive indirect compensation in connection with provision of certain services (namely, accounting, auditing, actuarial, appraisal, banking, certain consulting, custodial, insurance, participant investment advisory, legal, recordkeeping, securities or other investment brokerage, third party administration, or valuation services) or who provide an investment platform through which investment options are made available to participants and beneficiaries in participant-directed individual account plans.

These small service providers will, in connection with covered service arrangements, be required to disclose to plan fiduciaries certain information. Such information will include what services will be included in the arrangement and what direct and indirect compensation the service will receive in connection with the arrangement. Certain service providers whose arrangements make certain investment products available to plans also will be required to disclose to fiduciaries certain information relating to expenses associated with such products. Certain specified information generally must be disclosed before the arrangement is entered into or renewed, on request from a fiduciary, and when the information changes.

Preparing compliant disclosures often will require one or more professional skills such as financial or legal expertise, and knowledge of financial products and services and related compensation and revenue sharing arrangements. Generally, small service providers will be responsible for disclosing only those types of compensation arrangements to which they (or their affiliate or subcontractor performing the services) are a party.

e. Agency Steps To Minimize Negative Impacts

As explained in (b) above in connection with public comments, the Department took a number of steps to minimize any negative impact of this interim final rule on small service providers. These include clarifying the scope of the rule's application to include only those service providers and compensation arrangements that are likely to require close consideration by plan fiduciaries, excepting from the rule's requirements contracts or arrangements where compensation or fees are less than $1,000, and omitting from the rule a requirement that all arrangements be maintained under formal contracts. The disclosure requirements included in the interim final rule are necessary to ensure that plan fiduciaries can efficiently and effectively carry out their duties in purchasing services for plans.

The policy justification for these requirements includes benefits to fiduciaries, who will realize savings in the form of reduced search costs more than commensurate to the compliance costs shouldered by service providers. Small plan fiduciaries are likely to benefit most—lacking economies of scale and negotiating power, they would otherwise face the greatest potential cost to obtain and consider the information necessary to the performance of their duty. Small service providers, while shouldering the cost of providing disclosure, will likely often pass these costs to their plan clients, who in turn will reap a net benefit on average that will more than offset this shifted compliance cost.

Major alternatives considered by the Department fell short of the approach adopted in the interim final rule of achieving policy goals at reasonable and justified cost. As discussed, the Department rejected as unnecessarily costly approaches that would have applied disclosure requirements to arrangements involving compensation or fees of less than $1,000, to indirect service arrangements where the service provider is not a plan fiduciary, or that would have required a formal, written contract or arrangement to delineate the disclosure obligations. The Department also rejected these approaches as inadequate to achieve a central policy and legal goal—namely, enabling plan fiduciaries, including especially small plan fiduciaries, to efficiently and effectively carry out their duties in connection with the purchase of plan services by easing their access to necessary information.

An alternative approach advocated by some public commenters would not have expressly conditioned the section 408(b)(2) prohibited transaction exemption on the service provider's production of such information. That approach, however, would perpetuate the information asymmetry and therefore would not allow small plan fiduciaries to efficiently and effectively carry out their fiduciary obligations when purchasing plan services and equip them to redress service provider abuses.

11. Paperwork Reduction Act

In accordance with the requirements of the Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3506(c)(2)), the proposed regulation solicited comments on the information collections included therein. The Department also submitted an information collection request (ICR) to OMB in accordance with 44 U.S.C.

3507(d), contemporaneously with the publication of the proposed regulation, for OMB's review.[48] Although no public comments were received that specifically addressed the paperwork burden analysis of the information collections, the comments that were submitted, and which are described earlier in this preamble, contained information relevant to the costs and administrative burdens attendant to the proposals. The Department took into account such public comments in connection with making changes to the proposal, analyzing the economic impact of the proposals, and developing the revised paperwork burden analysis summarized below.

In connection with publication of this interim final rule, the Department submitted an ICR to OMB for its request of a new information collection. OMB approved the ICR on May 20, 2010, under OMB Control Number 1210–0133, which will expire on May 31, 2013.

A copy of the ICR may be obtained by contacting the PRA addressee shown below or at *http://www.RegInfo.gov.* PRA ADDRESSEE: G. Christopher Cosby, Office of Policy and Research, U.S. Department of Labor, Employee Benefits Security Administration, 200 Constitution Avenue, NW., Room N–5718, Washington, DC 20210. Telephone: (202) 693–8410; Fax: (202) 219–4745. These are not toll-free numbers.

The information collection requirements of the interim final rule are contained in paragraph (c)(1)(iv), which requires service providers to disclose, in writing, specific information to responsible plan fiduciaries related to the compensation to be received under the contract or arrangement. Generally, the information must be disclosed reasonably in advance of the date the contract or arrangement is entered into, or extended or renewed. These disclosure requirements are discussed fully in section B. of this **SUPPLEMENTARY INFORMATION.**

Annual Hour Burden

In order to estimate the potential costs of the disclosure provisions of the interim final rule, the Department estimated the number of service providers, plans, and arrangements covered by the rule. Based on information from the 2006 Form 5500, the Department estimates that approximately 49,000 defined benefit pension plans (DB plans) covering more than 42 million participants and approximately 646,000 defined contribution plans (DC plans) covering almost 80 million participants are covered by the rule.[49]

The Department also estimates that based on data from the 2006 Form 5500 Annual Return/Report and Schedule C that there are almost 10,000 covered service providers. The 2006 Form 5500 Schedule C data was also used to count the number of covered plan-service provider arrangements. On average, DB plans employ more covered service providers per plan than DC plans, and large plans use more covered service providers per plan than small plans. In total, the Department estimates that DB plans have approximately 119,000 arrangements with covered service providers, while DC plans have an estimated 780,000 arrangements. For purposes of this analysis, the Department assumes that about 50 percent of disclosures between service providers and plan fiduciaries are made only electronically.

Compliance Review and Implementation: Most of the hour burden under the interim final rule will be imposed on service providers. Covered service providers will need to review the rule, evaluate whether their current disclosure practices comply with its requirements, and, if not, determine how their disclosure practices must be changed to be compliant. The Department projected this as an hour burden incurred in 2011, the year in which the rule takes effect.

Although all covered service providers are assumed to incur these initial costs, it is likely that service providers with complex fee arrangements and conflicts of interest will require more time to comply. The Department assumes that the number of service providers with more complex arrangements can be approximated by the number of unique service providers who are reported on the Schedule C as having received $1 million or more in compensation (approximately 1,000 service providers).

The Department assumes that covered service providers with complex arrangements will require 24 hours of legal professional time and 80 hours of financial professional time.[50] The non-complex service providers (approximately 9,000 service providers based on the quantitative analysis above) would require only three hours of legal professional time and 13 hours of financial professional time. Based on the foregoing, the Department estimates that in the first year service providers will incur an hour burden of approximately 241,000 hours with an equivalent cost of approximately $17.9 million.

The Department also has estimated the initial compliance review and implementation costs for service providers newly entering the market (“new service providers”) to provide service to plans (either for the first time or by re-entry) beginning in 2012 and each year thereafter. Based on data from the 2005 and 2006 Form 5500, the Department assumes that about eight percent of all service providers will be new in each year subsequent to 2011, and that these service providers will incur the same compliance review and implementation costs as existing service providers. Based on the foregoing, the Department estimates that new service providers will incur an hour burden of approximately 20,000 hours with an equivalent cost of approximately $1.5 million.

Based on the foregoing, the Department estimates that the three-year average total hour burden associated with compliance review and implementation is almost 94,000 hours. The equivalent cost of these hours is $7.0 million.

Initial Disclosure: As discussed above, covered service providers also must develop or update their current disclosure materials to comply with the regulatory requirements. Paragraph (c)(1)(iv) of the rule requires service providers to disclose general information to a responsible plan fiduciary when a contract is entered into, renewed, or extended. The Department assumes that service providers will create a general disclosure that can be used for all plans and customize this document by adding individualized information for each plan. This activity includes developing formulae and algorithms to present or estimate direct and indirect compensation that will be applied in a pro forma projection for each plan with which the provider will contract. The Department assumes that the majority of

[48] On Dec. 3, 2007, OMB issued a notice (ICR Reference No. 200710–1210–001) that it would not approve the Department's request for approval of the information collection provisions until after consideration of public comment on the proposed regulation and promulgation of a final rule, describing any changes. OMB issued Control Number 1210–0133 for the collection once it approved the information collection provisions of the final rule.

[49] Out of these pension plans, about 37,000 are small DB plans and 576,000 small DC plans. Small plans generally are those with less than 100 participants.

[50] EBSA wage estimates for 2010 are based on the National Occupational Employment Survey (May 2008, Bureau of Labor Statistics) and the Employment Cost Index (June 2009, Bureau of Labor Statistics), unless otherwise noted. Total labor costs (wages plus benefits plus overhead) were estimated to average $119.03 per hour over the period for legal professional, $62.81 for financial professionals, and $26.14 per hour for clerical staff.

this cost would be incurred by service providers in 2011 and that one hour of a legal professional's and 45 minutes of a financial professional's time will be required to prepare the general disclosure for each plan. Based on the foregoing, the total hour burden to prepare these disclosures in year 2011 will be approximately 1.6 million hours and the equivalent cost of these hours will be approximately $150 million.

In 2012 and subsequent years, the regulation will cause additional disclosures to be made between covered plans and service providers for any new contracts and arrangements. The Department does not have information on the number of new arrangements in a year; therefore, the Department used the percentage of plans that are new plans, about 14 percent, as a proxy for the percentage of new arrangements in a year. This results in approximately 122,000 new arrangements every year. The Department assumes that half of the responsible plan fiduciaries in these arrangements would receive the required information even without the regulation enacted. The Department estimates that preparing the disclosures for new arrangements will require one hour of a legal professional's time at an equivalent cost of approximately $119 and 45 minutes of a financial professional's time at an equivalent cost of almost $63. Based on the foregoing, the total hour burden to prepare these disclosures in year 2012 and thereafter will be approximately 215,000 hours and the equivalent cost of these hours will be $20.3 million. The resulting three-year average burden hours is 673,000 hours with an equivalent cost of $63.5 million.

Paragraph (c)(1)(vi) requires service providers to provide any other information relating to 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 upon the request of responsible plans fiduciaries or plan administrators of covered plans. The Department is not aware of a basis for determining the number of requests that responsible plan fiduciaries or plan administrators will make; therefore, it assumes that approximately ten percent (approximately 90,000) of responsible plan fiduciaries will request additional information annually. The Department further assumes that service providers already will have this information available, because it is required to comply with other legal requirements. Therefore, the Department estimates that it will take clerical staff two minutes per request to prepare the information with an hourly rate of approximately $26. Based on the foregoing, the Department estimates that the yearly and three-year average total hour burden to disclose information upon request will total 4,500 hours at an equivalent cost of $118,000.

Paragraph (c)(1)(v)(B) generally requires service providers to disclose any changes to the general information as soon as reasonably practicable, but no later than 60 days from the date the covered service provider knows of such change. The Department assumes that one-half hour of legal professional time and one-third hour of a financial professional time will be required to update the disclosures. The Department also assumes that changes in plan disclosures will occur at least once every three years, because plans normally conduct requests for proposal (RFPs) from service providers at least once every three to five years. If it is assumed that an equal number of plans conduct an RFP in any given year, then approximately 35 percent of arrangements will require an updated disclosure every year and half of these would already have updated the information without the regulation for a total of approximately 315,000 updates to the general information. Based on the foregoing, the Department estimates that the annual hour burden to update the disclosure of general information will be approximately 268,000 hours with an equivalent cost of approximately $25.5 million.

In summary, the hour burden to disclose the required general information in 2011 will be almost 1.6 million hours with an equivalent cost of approximately $150 million. The hour burden in subsequent years will be approximately 483,000 hours with an equivalent cost of approximately $45.8 million. The average total hour burden to disclose general information over the three year period 2011–2013 will be 852,000 hours, and the equivalent cost of these hours will be $80.5 million.

Investment Disclosure: Paragraphs (c)(1)(iv)(F) and (G) generally require fiduciaries to certain investment vehicles holding plan assets (described in paragraph (c)(1)(iii)(A)(*2*)) and providers of recordkeeping and brokerage services to a participant-directed individual account plan (without regard to whether they expect to receive indirect compensation), if they provide access to one or more designated investment alternatives for the covered plan (described in paragraph (c)(1)(iii)(B) ("platform providers")), to disclose investment-related compensation information. This information generally must be disclosed to the responsible plan fiduciary reasonably in advance of the date the contract or arrangement is entered into, extended or renewed.[51] Paragraph (c)(1)(iv)(G)(*2*) allows covered platform providers to satisfy this disclosure requirement by passing through to the responsible plan fiduciary copies of any state or federally regulated disclosure materials (*e.g.,* prospectuses) of the issuer of the designated investment alternative, so long as such issuer is not affiliated with the platform provider, and the platform provider does not know that any of the information contained in such materials is incomplete or inaccurate.

The hour burden associated with disclosing investment-related compensation and fee information will be attributable primarily to the time spent gathering the required information. However, much of this cost will be reduced, because, as discussed above, the rule allows platform providers to satisfy this requirement by passing through information to the responsible plan fiduciary. Based on the foregoing, the Department assumes that preparation of investment-related compensation and fee information will require one-half hour of financial professional time for each of the individual account plans. There will be approximately 462,000 plan fiduciaries receiving this information in 2011. Further, it is assumed that 14 percent (approximately 63,000) of arrangements will be new in each subsequent year and require the initial investment disclosure. The Department estimates that the hour burden to disclose the required investment information will be approximately 362,000 hours with an equivalent cost of $17.9 million in 2011. In the subsequent years, the burden hours will be approximately 249,000 hours with an equivalent cost of $2.4 million. The three-year average hour burden associated with disclosing investment related information 462,000 disclosures are 286,000 hours at an equivalent cost of $7.6 million.

In addition, service providers must disclose changes to investment information. The Department assumes that service providers will have to disclose investment information changes to each responsible plan fiduciary at least once per year due to the regulation, resulting in approximately 399,000 disclosures. This

[51] Generally, service providers must disclose any change to investment-related information as soon as practicable, but not later than 60 days from the date on which the covered service provider is informed of such change.

notification is expected to require one-half hour of financial professional time to prepare. Based on the foregoing, the cost to update investment information in subsequent years is estimated to be approximately 206,000 hours with an equivalent cost of $12.7 million. The Department estimates that the three-year average burden hours associated with reporting changes to the required investment related information will be 138,000 hours at an equivalent cost of $8.5 million.

In summary, the hour burden to disclose all investment information in 2011 is estimated to be 362,000 hours with an equivalent cost of $17.9 million. The burden to disclose the required investment information in subsequent years is 455,000 hours with an equivalent cost of $15.1 million. The total three-year hour burden for service providers to disclose the required investment information is estimate to be 424,000 hours with an equivalent cost of $16.1 million.

Hour Burden Imposed on Plans: The main hour burden of the regulation that is imposed on plans is additional time spent reviewing the regulation and ensuring that the plan has received all of the required disclosures. The Department estimates the responsible plan fiduciaries will need one hour of time to review new requirements. The hour burden is estimated to be 695,000 with an equivalent cost of approximately $43.6 million in 2011.

Starting in 2012 and each year thereafter, responsible plan fiduciaries of new plans will have to review the new requirements. Based on data from the 2005 and 2006 Form 5500, the Department estimates that 14 percent of plans will be new each year. The Department assumes that responsible plan fiduciaries of new plans will have the same costs as fiduciaries of existing plans. Therefore, the hour burden associated with the review for fiduciaries of new plans is estimated to be approximately 94,000 hours at an equivalent cost of $5.9 million for years 2012 and thereafter.

Based on the foregoing, the hour burden imposed on plans to review the regulation is estimated to be 695,000 hours in 2011 with an equivalent cost of $43.6 million. The three-year average burden on plans to review the regulation is estimated to be 294,000 hours with an equivalent cost of $18.5 million.

Exemption for Responsible Plan Fiduciary: The final prohibited transaction class exemption contained in paragraph (c)(1)(ix) of the rule provides relief from the restrictions of sections 406(a)(1)(C) and (D) for plan fiduciaries that enter into contracts or arrangements with service providers upon a mistaken belief that they have received all of the disclosures required by the interim final rule. Upon discovering that a covered service provider failed to disclose all of the required information, the responsible plan fiduciary must take reasonable steps to obtain such information, including requesting in writing that the covered service provider furnish the information in order to rely on the exemption and notify the Department if the service provider fails to comply with the written request within 90 days.

While the Department has no basis for estimating the percentage of arrangements where a responsible plan fiduciary will not receive all of the required disclosures from a covered service provider, the Department assumes that 10 percent of arrangements (approximately 69,000) may experience a failure that will require the responsible plan fiduciary to send a notice to the service provider in 2011. In 2012 and thereafter, the number of requests for missing information is expected to decrease to 5 percent of arrangements (approximately 35,000). The Department estimates that one-half hour of a financial professional's time will be required to prepare the request for the undisclosed information.

The Department estimates that the burden for plans to send notice to service providers of missing information will be approximately 35,000 hours with an equivalent cost of over $2.2 million in 2011. The hour burden for subsequent years is estimated to be over 18,000 hours with an equivalent cost of $1.1 million. The three-year average burden hours for requesting missing information is estimated to be 24,000 hours with an equivalent cost of $1.5 million.

The Department further assumes that service providers may not respond to 10 percent of the requests for undisclosed information within 90 days, which will result in the responsible plan fiduciary preparing and sending a notice to the Department. The Department estimates that one-half hour of a financial professional's time will be required to prepare the notice. The Department estimates that the burden for plans to send notice to the Department of Labor will be approximately 3,500 hours with an equivalent cost of $219,600 in 2011. The hour burden for subsequent years is estimated to be approximately 1,800 hours with an equivalent cost of $110,000. The three-year average burden hours to prepare the notice to be sent to the Department are estimated to be 2,400 hours with an equivalent cost of $146,000.

Summary

Table 12 shows the total hour burden of the information collection and Table 13 shows the total equivalent cost. The total three year average hour burden for service providers and plans is estimated to be 1.4 million hours with an equivalent cost of $104 million. The total three-year average hour burden for plans is estimated to be 320,000 hours with an equivalent cost of $20.1 million. The total three-year average hour burden of the regulation is estimated to be 1.7 million hours with an equivalent cost of $124 million.

TABLE 12—HOUR BURDEN

	Year 1	Year 2	Year 3	Average
Service Providers	2,197,000	963,000	963,000	1,374,000
Plans	733,000	114,000	114,000	320,000
Total	2,930,000	1,076,000	1,076,000	1,694,000

Note: The displayed numbers are rounded to the nearest thousand and therefore may not add up to the totals.

TABLE 13—EQUIVALENT COST

	Year 1	Year 2	Year 3	Average
Service Providers	$185,811,000	$62,529,000	$62,039,000	$103,623,000

TABLE 13—EQUIVALENT COST—Continued

	Year 1	Year 2	Year 3	Average
Plans	46,041,000	7,119,000	7,119,000	20,093,000
Total	231,852,000	69,648,577	69,158,577	123,716,000

Note: The displayed numbers are rounded to the nearest thousand and therefore may not add up to the totals.

Annual Cost Burden

Table 14 reports the estimated printing and postage costs associated with each required notice and disclosure. The Department assumes that 50 percent of the disclosures will be sent electronically at no cost, and that the cost of printing and paper for the remaining 50% of documents will be 5 cents per page. The Department estimates that the total cost burden of the rule in 2010 will be $8,830,000 (approximately $8,810.000 for service providers and $21,000 for plans), and $1,435,000 (approximately $1,424,000 for service providers and $10,000 for plans in subsequent years. The three-year average cost burden is estimated to be almost $3.9 million.

TABLE 14—COST BURDEN

	Year 1	Year 2	Year 3	Average
Initial Disclosure	$378,000	$51,000	$51,000	$160,000
Update Initial Disclosure	0	101,000	101,000	67,000
Information Upon Request	42,000	42,000	42,000	42,000
General Information Total	420,000	194,000	194,000	270,000
Investment Disclosure	8,290,000	1,122,000	1,122,000	3,509,000
Update Investment Disclosure	108,000	108,000	108,000	108,000
Investment Disclosure Total	8,390,000	1,230,000	1,230,000	3,617,000
Request for Additional Information for Exemption	19,000	9,000	9,000	13,000
Notice to DOL	2000	900	900	1,000
Total	8,830,000	1,435,000	1,435,000	3,900,000

Note: The displayed numbers are rounded to the nearest thousand and therefore may not add up to the totals.

These paperwork burden estimates are summarized as follows:

Type of Review: New collection (Request for new OMB control number).

Agency: Employee Benefits Security Administration, Department of Labor.

Title: Reasonable Contract or Arrangement Under Section 408(b)(2)—Fee Disclosure.

OMB Control Number: 1210–0133.

Affected Public: Business or other for-profit; not-for-profit institutions.

Estimated Number of Respondents: 79,000 (first year); 56,000 (three-year average).

Estimated Number of Responses: 1,528,000 (first year); 1,194,000 (three-year average).

Frequency of Response: Annually; occasionally.

Estimated Annual Burden Hours: 2,930,000 (first year); 1,694,000 (three-year average).

Estimated Annual Burden Cost: $8,830,000 (first year); $3,900,000 (three-year average).

Congressional Review Act

The interim final rule is subject to the Congressional Review Act provisions of the Small Business Regulatory Enforcement Fairness Act of 1996 (5 U.S.C. 801 *et seq.*) and will be transmitted to Congress and the Comptroller General for review. The interim final rule is a "major rule" as that term is defined in 5 U.S.C. 804, because it is likely to result in an annual effect on the economy of $100 million or more.

Unfunded Mandates Reform Act

For purposes of the Unfunded Mandates Reform Act of 1995 (Pub. L. 104–4), as well as Executive Order 12875, the interim final rule does not include any Federal mandate that may result in expenditures by State, local, or tribal governments in the aggregate of more than $100 million, adjusted for inflation, or increase expenditures by the private sector of more than $100 million, adjusted for inflation.

Federalism Statement

Executive Order 13132 (August 4, 1999) outlines fundamental principles of federalism, and requires the adherence to specific criteria by Federal agencies in the process of their formulation and implementation of policies that have substantial direct effects on the States, the relationship between the national government and States, or on the distribution of power and responsibilities among the various levels of government. The interim final rule does not have federalism implications because it has no substantial direct effect on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government. Section 514 of ERISA provides, with certain exceptions specifically enumerated, that the provisions of Titles I and IV of ERISA supersede any and all laws of the States as they relate to any employee benefit plan covered under ERISA. The requirements implemented in the interim final rule do not alter the fundamental reporting and disclosure requirements of the statute with respect to employee benefit plans, and, as such, have no implications for the States or the relationship or distribution of power between the national government and the States.

List of Subjects in 29 CFR Part 2550

Employee benefit plans, Exemptions, Fiduciaries, Investments, Pensions, Prohibited transactions, Reporting and recordkeeping requirements, and Securities.

■ For the reasons set forth in the preamble, the Department amends chapter XXV, subchapter F, part 2550 of title 29 of the Code of Federal Regulations as follows:

SUBCHAPTER F—FIDUCIARY RESPONSIBILITY UNDER THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

PART 2550–RULES AND REGULATIONS FOR FIDUCIARY RESPONSIBILITY

■ 1. The authority citation for part 2550 continues to read as follows:

Authority: 29 U.S.C. 1135; and Secretary of Labor's Order No. 1–2003, 68 FR 5374 (Feb. 3, 2003). Sec. 2550.401b–1 also issued under sec. 102, Reorganization Plan No. 4 of 1978, 43 FR 47713 (Oct. 17, 1978), 3 CFR, 1978 Comp. 332, effective Dec. 31, 1978, 44 FR 1065 (Jan. 3, 1978), 3 CFR, 1978 Comp. 332. Sec. 2550.401c–1 also issued under 29 U.S.C. 1101. Sec. 2550.404c–1 also issued under 29 U.S.C. 1104. Sec. 2550.407c–3 also issued under 29 U.S.C. 1107. Sec. 2550.404a–2 also issued under 26 U.S.C. 401 note (sec. 657, Pub. L. 107–16, 115 Stat. 38). Sec. 2550.408b–1 also issued under 29 U.S.C. 1108(b) (1) and sec. 102, Reorganization Plan No. 4 of 1978, 3 CFR, 1978 Comp. p. 332, effective Dec. 31, 1978, 44 FR 1065 (Jan. 3, 1978), and 3 CFR, 1978 Comp. 332. Sec. 2550.408b–2 also issued under sec. 102, Reorganization Plan No. 4 of 1978, 3 CFR, 1978 Comp. p. 332, effective Dec. 31, 1978, 44 FR 1065 (Jan. 3, 1978), and 3 CFR, 1978 Comp. 332. Sec. 2550.412–1 also issued under 29 U.S.C. 1112.

■ 2. Section 2550.408b–2(c) is revised to read as follows:

§ 2550.408b–2 General statutory exemption for services or office space.

* * * * *

(c) *Reasonable contract or arrangement*—

(1) *Pension plan disclosure.*

(i) *General.* No contract or arrangement for services between a covered plan and a covered service provider, nor any extension or renewal, is reasonable within the meaning of section 408(b)(2) of the Act and paragraph (a)(2) of this section unless the requirements of this paragraph (c)(1) are satisfied. The requirements of this paragraph (c)(1) are independent of fiduciary obligations under section 404 of the Act.

(ii) *Covered plan.* For purposes of this paragraph (c)(1), a "covered plan" is an "employee pension benefit plan" or a "pension plan" within the meaning of section 3(2)(A) (and not described in section 4(b)) of the Act, except that the term "covered plan" shall not include a "simplified employee pension" described in section 408(k) of the Internal Revenue Code of 1986 (the Code), a "simple retirement account" described in section 408(p) of the Code, an individual retirement account described in section 408(a) of the Code, or an individual retirement annuity described in section 408(b) of the Code.

(iii) *Covered service provider.* For purposes of this paragraph (c)(1), 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 services described in paragraphs (c)(1)(iii)(A), (B), or (C) of this section pursuant to the contract or arrangement, regardless of whether such services will be performed, or such compensation received, by the covered service provider, an affiliate, or a subcontractor.

(A) *Services as a fiduciary or registered investment adviser.*

(*1*) Services provided directly to the covered plan as a fiduciary (unless otherwise specified, a "fiduciary" in this paragraph (c)(1) is a fiduciary within the meaning of section 3(21) of the Act);

(*2*) 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

(*3*) Services provided directly to the covered plan as an investment adviser registered under either the Investment Advisers Act of 1940 or any State law.

(B) *Certain recordkeeping or brokerage services.* 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.

(C) *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 (as defined in paragraph (c)(1)(viii)(B)(*2*) of this section) or compensation described in paragraph (c)(1)(iv)(C)(*3*) of this section).

(D) *Limitations.* Notwithstanding paragraphs (c)(1)(iii)(A), (B), or (C) of this section, no person or entity is a "covered service provider" solely by providing services—

(*1*) As an affiliate or a subcontractor that is performing one or more of the services described in paragraphs (c)(1)(iii)(A), (B), or (C) of this section under the contract or arrangement with the covered plan; or

(*2*) 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 as a fiduciary described in paragraph (c)(1)(iii)(A)(*2*) of this section.

(iv) *Initial disclosure requirements.* The covered service provider must disclose the following information to a responsible plan fiduciary, in writing—

(A) *Services.* A description of the services to be provided to the covered plan pursuant to the contract or arrangement (but not including non-fiduciary services described in paragraph (c)(1)(iii)(D)(*2*) of this section).

(B) *Status.* 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) as a fiduciary; 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.

(C) *Compensation.*

(*1*) *Direct compensation.* A description of all direct compensation (as defined in paragraph (c)(1)(viii)(B)(*1*) of this section), 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 described pursuant to paragraph (c)(1)(iv)(A) of this section.

(*2*) *Indirect compensation.* A description of all indirect compensation (as defined in paragraph (c)(1)(viii)(B)(*2*) of this section) that the covered service provider, an affiliate, or a subcontractor reasonably expects to receive in connection with the services described pursuant to paragraph (c)(1)(iv)(A) of this section; including identification of the services for which the indirect compensation will be received and identification of the payer of the indirect compensation.

(*3*) *Compensation paid among related parties.* A description of any compensation that will be paid among the covered service provider, an affiliate, or a subcontractor, in connection with the services described pursuant to paragraph (c)(1)(iv)(A) of this section 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 pursuant to this paragraph (c)(1)(iv)(C)(*3*) regardless of whether such compensation also is disclosed pursuant to paragraph (c)(1)(iv)(C)(*1*) or (*2*), (F) or (G) of this section. This paragraph (c)(1)(iv)(C)(*3*) shall not apply to compensation received by an employee from his or her employer on account of work performed by the employee.

(*4*) *Compensation for termination of contract or arrangement.* 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.

(D) *Recordkeeping services.* Without regard to the disclosure of compensation pursuant to paragraph (c)(1)(iv)(C), (F), or (G) of this section, if recordkeeping services will be provided to the covered plan—

(*1*) 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

(*2*) 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.

(E) *Manner of receipt.* A description of the manner in which the compensation described in paragraph (c)(1)(iv)(C) and (D) of this section 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.

(F) *Investment disclosure—fiduciary services.* In the case of a covered service provider described in paragraph (c)(1)(iii)(A)(*2*) of this section, the following additional information with respect to each investment contract, product, or entity that holds plan assets and in which the covered plan has a direct equity investment, and for which fiduciary services will be provided pursuant to the contract or arrangement with the covered plan, unless such information is disclosed to the responsible plan fiduciary by a covered service provider providing recordkeeping services or brokerage services as described in paragraph (c)(1)(iii)(B) of this section—

(*1*) 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.,* sales loads, sales charges, deferred sales charges, redemption fees, surrender charges, exchange fees, account fees, and purchase fees);

(*2*) A description of the annual operating expenses (*e.g.,* expense ratio) if the return is not fixed; and

(*3*) A description of any ongoing expenses in addition to annual operating expenses (*e.g.,* wrap fees, mortality and expense fees).

(G) *Investment disclosure—recordkeeping and brokerage services.*

(*1*) In the case of a covered service provider described in paragraph (c)(1)(iii)(B) of this section, the additional information described in paragraph (c)(1)(iv)(F)(*1*) through (*3*) of this section with respect to each designated investment alternative for which recordkeeping services or brokerage services as described in paragraph (c)(1)(iii)(B) of this section will be provided pursuant to the contract or arrangement with the covered plan.

(*2*) A covered service provider may comply with this paragraph (c)(1)(iv)(G) by providing current disclosure materials of the issuer of the designated investment alternative that include the information described in such paragraph, provided that such issuer is not an affiliate, the disclosure materials are regulated by a State or federal agency, and the covered service provider does not know that the materials are incomplete or inaccurate.

(v) *Timing of initial disclosure requirements; changes.*

(A) A covered service provider must disclose the information required by paragraph (c)(1)(iv) of this section to the responsible plan fiduciary reasonably in advance of the date the contract or arrangement is entered into, and extended or renewed, except that—

(*1*) 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, the information required by paragraph (c)(1)(iv) of this section must be disclosed 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; and

(*2*) The information described in paragraph (c)(1)(iv)(G) of this section relating to any investment alternative that is not designated at the time the contract or arrangement is entered into must be disclosed as soon as practicable, but not later than the date the investment alternative is designated by the responsible plan fiduciary.

(B) A covered service provider must disclose a change to the information required by paragraph (c)(1)(iv) of this section 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.

(vi) *Reporting and disclosure information; timing.*

(A) Upon 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 the Act and the regulations, forms and schedules issued thereunder.

(B) The covered service provider must disclose the information required by paragraph (c)(1)(vi)(A) of this section not later than 30 days following receipt of a written request from the responsible plan fiduciary or covered plan administrator, 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.

(vii) *Disclosure errors.* No contract or arrangement will fail to be reasonable under this paragraph (c)(1) solely because the covered service provider, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the information required pursuant to paragraph (c)(1)(iv) or (vi) of this section, 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.

(viii) *Definitions.* For purposes of paragraph (c)(1) of this section:

(A) *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" in this paragraph (c)(1) refers to an affiliate of the covered service provider.

(B) *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.

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

(*2*) "*Indirect*" compensation is compensation received from any source other than the covered plan, the plan sponsor, the covered service provider, an affiliate, or a subcontractor (if the subcontractor receives such compensation in connection with services performed under the subcontractor's contract or arrangement described in paragraph (c)(1)(viii)(F) of this section).

(*3*) A description or an estimate of compensation 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 cannot reasonably be expressed in such terms, by any other reasonable method. Any description or estimate must contain sufficient information to permit evaluation of the reasonableness of the compensation.

(C) *Designated investment alternative.* A "designated investment alternative" is any investment alternative designated by a fiduciary 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 specifically designated.

(D) *Recordkeeping services.* "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.

(E) *Responsible plan fiduciary.* 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.

(F) *Subcontractor.* 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 one or more services described pursuant to paragraph (c)(1)(iii)(A) through (C) of this section provided for by the contract or arrangement with the covered plan.

(ix) *Exemption for responsible plan fiduciary.* Pursuant to section 408(a) of the Act, the restrictions of section 406(a)(1)(C) and (D) of the Act shall not apply to a responsible plan fiduciary, notwithstanding any failure by a covered service provider to disclose information required by paragraph (c)(1)(iv) or (vi) of this section, if the following conditions are met:

(A) The responsible plan 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 by paragraph (c)(1)(iv) or (vi) of this section;

(B) The responsible plan fiduciary, upon discovering that the covered service provider failed to disclose the required information, requests in writing that the covered service provider furnish such information;

(C) If the covered service provider fails to comply with such written request within 90 days of the request, then the responsible plan fiduciary notifies the Department of Labor of the covered service provider's failure, in accordance with paragraph (c)(1)(ix)(E) of this section;

(D) 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;

(E) The notice shall be filed with the Department not later than 30 days following the earlier of—

(*1*) The covered service provider's refusal to furnish the information requested by the written request described in paragraph (c)(1)(ix)(B) of this section; or

(*2*) 90 days after the written request referred to in paragraph (c)(1)(ix)(B) of this section is made;

(F) The notice required by paragraph (c)(1)(ix)(C) of this section shall be sent to the following address: U.S. Department of Labor, Employee Benefits Security Administration, Office of Enforcement, 200 Constitution Ave., NW., Suite 600, Washington, DC 20210; or may be sent electronically to *OE-DelinquentSPnotice@dol.gov;* and

(G) The responsible plan fiduciary, following discovery of a failure to disclose required information, shall determine whether to terminate or continue the contract or arrangement. In making such a determination, the responsible plan fiduciary shall evaluate the nature of the failure, the availability, qualifications, and cost of replacement service providers, and the covered service provider's response to notification of the failure.

(x) *Preemption of State law.* Nothing in this section shall 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 this section.

(xi) *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.

(xii) *Effective date.* Paragraph (c) of this section shall be effective on July 16, 2011. Paragraph (c)(1) of this section shall apply to contracts or arrangements between covered plans and covered service providers as of the effective date, without regard to whether the contract or arrangement was entered into prior to such date; for contracts or arrangement entered into prior to the effective date, the information required to be disclosed pursuant to paragraph (c)(1)(iv) of this section must be furnished no later than the effective date.

(2) *Welfare plan disclosure.* [Reserved]

(3) *Termination of contract or arrangement.* No contract or arrangement is reasonable within the meaning of section 408(b)(2) of the Act and paragraph (a)(2) of this section if it does not permit termination by the plan without penalty to the plan on reasonably short notice under the circumstances to prevent the plan from becoming locked into an arrangement that has become disadvantageous. A long-term lease which may be terminated prior to its expiration (without penalty to the plan) on reasonably short notice under the circumstances is not generally an unreasonable arrangement merely because of its long term. A provision in a contract or other arrangement which reasonably compensates the service provider or lessor for loss upon early termination of the contract, arrangement, or lease is not a penalty. For example, a minimal fee in a service contract which is charged to allow recoupment of reasonable start-up costs is not a penalty. Similarly, a provision in a lease for a termination fee that covers reasonably foreseeable expenses related to the vacancy and reletting of the office space upon early termination of the lease is not a penalty. Such a provision does not reasonably compensate for loss if it provides for payment in excess of actual loss or if it fails to require mitigation of damages.

* * * * *

Signed at Washington, DC, this 6th day of July, 2010.

Phyllis C. Borzi,

Assistant Secretary, Employee Benefits Security Administration, Department of Labor.

[FR Doc. 2010–16768 Filed 7–15–10; 8:45 am]

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