May 4, 2011

Hon. Phyllis C. Borzi  
Assistant Secretary of Labor  
Employee Benefits Security Administration  
U.S. Department of Labor  
Frances Perkins Building  
200 Constitution Avenue, NW  
Washington, DC 20210

Re: Comments on the Interim Final Regulations Relating to Compensation to Service Providers  
Under Section 408(b)(2) of ERISA

Dear Assistant Secretary Borzi:

Enclosed are comments on the interim final regulations relating to compensation to service providers under section 408(b)(2) of ERISA. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

[Signature]

Charles H. Egerton  
Chair, Section of Taxation

Enclosure

cc: Douglas Shulman, Commissioner, Internal Revenue Service  
Michael Mundaca, Assistant Secretary (Tax Policy), Department of the Treasury  
William Wilkins, Chief Counsel, Internal Revenue Service
These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Andrew L. Oringer of the Employee Benefits Committee of the Section of Taxation. Substantive contributions were made by Matthew J. Eickman, Barbara D. Klippert, David C. Olstein, David J. Passey, Steven W. Rabitz, Kenneth A. Raskin, and Jeffrey Ross. The Comments were reviewed by Joni L. Andrioff, a Committee Vice Chair, and John L. Utz, Committee Chair. The Comments were further reviewed by James R. Raborn of the Section’s Committee on Government Submissions and by Thomas R. Hoecker, Council Director for the Employee Benefits Committee.

Although the members of the Section of Taxation who participated in preparing these Comments have clients who might be affected by the rules addressed by these Comments, no such member or the firm or organization to which such member belongs has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these comments.

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Date: May 4, 2011
EXECUTIVE SUMMARY

Section 408(b)(2) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"),\(^1\) provides an exemption from the prohibited transaction rules for “[c]ontracting or making reasonable arrangements with a party in interest for office space, or legal, accounting, or other services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid therefor.” Section 2550.408b-2 of the regulations (the “DOL Regulations”) of the U.S. Department of Labor (the “DOL”), initially promulgated over 30 years ago, provided authority regarding the requirements that must be satisfied for a service arrangement to be considered “reasonable” and for services to be considered “necessary.”

The DOL, noting, among other things, numerous market-based changes (such as movement to “401(k)” plans and technological changes) that transpired since the section 408(b)(2) regulations were initially issued,\(^2\) proposed an amendment to section 2550.408b-2 of the DOL Regulations (the “Proposed Regulation”)\(^3\) setting forth new requirements that would have to be met for services to meet the requirements of section 408(b)(2). After an extensive public record on the Proposed Regulation was developed, the DOL issued an interim final regulation under section 408(b)(2) (the “Interim Final Regulation”).\(^4\)

In response to requests for comments from the DOL,\(^5\) we recommend, as discussed in greater detail below, that final regulations under section 408(b)(2) (“Final Regulations”):

1. Allow service providers to satisfy their obligation to update non-monetary compensation disclosures through the provision on an annual basis of information on Form 5500, Annual Return/Report of Employee Benefit Plan, Schedule C, Service Provider Information;

2. Reconcile the DOL’s guidance related to the receipt of de minimis gifts and entertainment by providing that the applicable threshold is an annual threshold and harmonizing the varying approaches currently taken by the DOL for different purposes;

3. Provide that section 408(b)(2) need not be satisfied when the requirements of another statutory or administrative exemption are met and provide, for example, that general section 408(b)(2) requirements need not apply to vehicles that satisfy the requirements of an exemption specifically developed for securitization vehicles; and

4. Not be effective earlier than one year from the date Final Regulations are published in the Federal Register or, alternatively, provide transitional relief

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\(^1\) Pub. L. No. 93-406, 88 Stat. 829. References to a “section” are to a section of ERISA, unless otherwise indicated.
\(^5\) Id.
through December 31, 2012, if the service provider provides covered plans with a statement that the service provider made a good-faith effort and acted with reasonable diligence to comply with the disclosure requirements in a timely fashion, but was not able to complete the required disclosures by January 1, 2012.
I. BACKGROUND

Section 408(b)(2) provides an exemption from the prohibited transaction rules for “[c]ontracting or making reasonable arrangements with a party in interest for office space, or legal, accounting, or other services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid therefor.” The DOL initially promulgated regulations over 30 years ago under section 408(b) that provided authority regarding the requirements that must be satisfied for a service arrangement to be considered “reasonable” and for services to be considered “necessary.” The DOL observed that there have been numerous market-based changes since the section 408(b)(2) regulations were initially issued, including, for example, general movement by employers to “401(k)” and other participant-directed plans, and technological advances that have affected the platforms used to administer individual account plans. In light of these and other considerations, the DOL proposed an amendment to section 2550.408b-2 of the DOL Regulations that set forth new proposed requirements that would have to be met for services to meet the requirements of section 408(b)(2).

We commented on the Proposed Regulation in a November 19, 2008 letter. We recommended that, as a fundamental matter, the Final Regulations clarify that the section 408(b)(2) disclosure requirements do not apply to an entity that does not hold “plan assets” (a “Non-Plan Assets Entity”) merely because a plan has made an equity investment in such entity, and we made various other specific recommendations.

The DOL issued the Interim Final Regulation on July 16, 2010, noting the extensive public record developed in anticipation of this regulatory initiative. Our sense is that the market has reacted favorably to the Interim Final Regulation, viewing it as a balanced attempt to address a number of difficult issues in the context of a general regulatory attempt to increase disclosure and transparency regarding compensation for services to plans in a changed and changing market. For example, we particularly appreciate and agree with the DOL’s decision not to apply the new rules in the context of Non-Plan Assets Entities, as our 2008 comment letter suggested. It is against this backdrop that we offer comments to the Interim Final Regulation regarding certain particular issues.

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7 75 Fed. Reg. 41,600, 41,600-01 (2010).
II. DISCUSSION

A. Updating of Estimates

1. Summary

The Interim Final Regulation requires service providers to disclose to plans any change to the information that the service provider previously provided. This requirement applies to all of the information that the service provider provided including, but not limited to, difficult-to-estimate items such as non-monetary compensation. Non-monetary compensation in the form of gifts and entertainment is virtually impossible to estimate accurately before it is received and may vary significantly throughout the year and over the term of the contract. Some expenses may also require time-consuming and complex calculations to obtain a reasonable per-plan allocation. We believe that the difficulties associated with estimating non-monetary compensation will require service providers to devote substantial resources to monitoring estimates and calculating per plan allocations on an ongoing basis. Most plans already receive estimates of non-monetary compensation as required by the Schedule C reporting rules for Form 5500, and updates to estimates of non-monetary compensation may well be duplicative and less accurate than the Schedule C information that plans already receive.

2. Recommendation

We recommend that the Final Regulations allow service providers to satisfy their obligation to update non-monetary compensation disclosures through the provision on an annual basis of information on Form 5500, Schedule C.

3. Explanation

We acknowledge that it is important for plans to review and monitor non-monetary compensation received by plan service providers, as non-monetary compensation is not necessarily immaterial, and can also constitute a prohibited transaction under certain circumstances. However, in the particular case of non-monetary compensation, we do not believe that our recommendation would likely hinder a plan’s ability to review and monitor service providers’ compensation in a timely fashion or materially adversely affect the quality of information that a plan receives. Our recommendation is intended to make the disclosure process more efficient by allowing plans to continue to receive the required information on a timely basis while eliminating duplicative disclosures and decreasing the resources required to continuously update estimates of non-monetary compensation.

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8 Reg. § 2550.408b-2(c)(1)(v)(B).
B. Disclosure of Insignificant Non-Monetary Compensation

1. Summary

The Interim Final Regulation requires that a covered service provider furnish a description of all indirect compensation that it (or any affiliate or subcontractor) expects to receive in connection with its provision of covered services. Indirect compensation is anything of monetary value that is received from any source other than the covered plan, plan sponsor, covered service provider, an affiliate or a subcontractor, other than non-monetary compensation valued at $250 or less during the term of the contract or arrangement. Thus, the Interim Final Regulation contains a de minimis exception for gifts and entertainment valued at $250 or less during the term of the contract or arrangement.

Chapter 48 of the DOL’s Enforcement Manual provides a slightly different de minimis rule for gifts and entertainment. The Enforcement Manual states:

The Investigator/Auditor should treat as insubstantial, and not as an apparent violation of ERISA § 406(b)(3), the receipt by a fiduciary (including his or her relatives) of [certain gifts or entertainment] from any one individual or entity (including any employee, affiliate, or other related party) as long as their aggregate annual value is less than $250 and their receipt does not violate any plan policy or provision . . . .

The rules governing the preparation of the Form 5500 contain yet a third de minimis rule relating to gifts and entertainment. For Form 5500 purposes, gifts or entertainment do not have to be reported on Schedule C if “[t]he gift or gratuity [is] valued at less than $50, and the aggregate value of gifts from one source in a calendar year [is] less than $100, but gifts with a value of less than $10 do not need to be counted toward the $100 limit.”

2. Recommendation

We recommend that the Final Regulations reconcile the DOL’s guidance related to the receipt of de minimis gifts and entertainment by providing that the applicable threshold is an annual threshold, and harmonizing the varying approaches currently taken by the DOL for different purposes.

3. Explanation

Because the Interim Final Regulation looks to the term of the contract or arrangement rather than annual periods, a covered service provider could be required to provide disclosure about insubstantial gifts or entertainment that would neither be reportable for Form 5500.

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9 Reg. § 2550.408b-2(c)(1)(iv).
12 Reg. § 2550.408b-2(c)(1)(viii)(B).
purposes nor raise concerns under the Enforcement Manual, each of which contain an annual threshold. In addition, there is the possibility of amounts not covered under the rules governing the Form 5500 being subject to the Interim Final Regulation, and vice versa. For example, three gifts valued at $99 in total would be regarded as de minimis for Form 5500 purposes, while being material under the Interim Final Regulation, and two gifts valued at $100 in total would be de minimis under the Interim Final Regulation, while being material for Form 5500 purposes. In effect, since compliance with all rules will in various cases be effectively required, the unconformed rules have the result of subjecting the amounts to all sets of requirements simultaneously. Thus, even if a covered service provider has instituted appropriate policies to comply with the Interim Final Regulation and Enforcement Manual threshold, the covered service provider will have to have separate systems in place to track gifts and entertainment for Form 5500 purposes. We do not believe that the policies underlying the various requirements should give rise to different de minimis requirements, and we believe that reconciling these three sets of rules will help covered service providers better understand their obligations, increase the likelihood of consistent interpretation and enforcement, and lower compliance costs.

C. Effect on Other Exemptions; Structured Vehicles

1. Summary

Numerous statutory and administrative exemptions have been developed to address various activities and circumstances involving retirement plans, sometimes specifically and sometimes more generally. For example, certain securitization vehicles may qualify for relief under Prohibited Transaction Class Exemption 83-1\(^6\) or similar individual exemptions, such as Prohibited Transaction Individual Exemption 2007-5\(^7\) (collectively the “Securitization Exemptions”). Service providers to securitization vehicles commonly rely on the Securitization Exemptions in connection with the servicing and operation of securitization vehicles. If benefit plan investors might own 25% or more of any class of equity of the vehicle, it is possible that the vehicle might be one whose assets would be “plan assets” under section 3(42) and related DOL Regulations (a “Plan Assets Entity”).

2. Recommendation

We recommend that the Final Regulations provide that section 408(b)(2) need not be satisfied when the requirements of another statutory or administrative exemption are met. We believe, for example, that the Final Regulations should not provide that general section 408(b)(2) requirements apply to vehicles that satisfy the requirements of a Securitization Exemption.

3. Explanation

In the preamble to the Interim Final Regulation, the DOL stated that it is “expressing no view at this time on the relationship of the 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.”

We believe that existing exemptions developed to address particular (or particular types) of activities and circumstances ordinarily should operate independently, and thus should apply without regard to general section 408(b)(2) principles. We believe that, in the case of a specialized exemption, rules regarding fees should be reviewed by the DOL as a part of the consideration of that specific exemption.

For example, securitization vehicles are highly specialized vehicles implicating a variety of comprehensive, detailed, and complex contractual and legal rules, and the Securitization Exemptions have been developed carefully over time to address the relevant issues. However, the Interim Final Regulation states that, to qualify for the section 408(b)(2) exemption, a service provider must, under the Interim Final Regulation, provide disclosure with respect to “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 . . . and 29 CFR 2510.3-101) and in which the covered plan has a direct equity investment . . . .” Thus, if a securitization vehicle were to be structured as a Plan Assets Entity that satisfies a Securitization Exemption it might still run afoul of ERISA if additional section 408(b)(2) requirements apply and remain unsatisfied. We believe that, in light of the numerous special considerations applicable in the case of securitization vehicles, the DOL should not consider overlaying general section 408(b)(2) requirements on the requirements of the Securitization Exemptions.

We emphasize that the Securitization Exemptions are only one example of a situation in which the application of section 408(b)(2) requirements may be unnecessary and inadvisable when exemptive relief is otherwise available. We expressly note that we are not suggesting by our discussion of securitization vehicles that section 408(b)(2) requirements should be made applicable in any other case in which relief for an arrangement is available under another exemption.

D. Effective Date

1. Summary

The Interim Final Regulation was to have become effective on July 16, 2011. However, the Interim Final Regulation as issued would have required significant changes to the information disclosed with respect to existing and new service provider arrangements. Service providers are struggling with the tremendous burden of preparing disclosures for hundreds, and in some instances thousands, of existing covered plan clients. In addition, because the disclosures are required to cover not only those products and services currently marketed but also legacy arrangements no longer marketed but still in place for existing clients, the scope of this effort must of necessity be considerably broader than a disclosure requirement prospectively applicable only to new arrangements. The preparation process involves several steps including, but not limited to, identifying covered products and services, determining what compensation is reportable, and reviewing current disclosure materials and contracts. Many service providers

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20 Reg. § 2550.408b-2(c)(1)(xii).
will also be required to make systems changes, which, we think, in light of our experience with the changes to the Form 5500 reporting rules, cannot be completed within one year.

The Interim Final Regulation also imposes disclosure rules that are different than the Schedule C reporting rules for Form 5500, and as a result, service providers will not be able to fully leverage the systems and procedural changes that they completed to comply with those requirements. Even without systems changes, the Interim Final Regulation requires disclosures at the time of the establishment of the arrangement, and it can be more difficult for a service provider to make reasonable estimates of compensation before it has been received than it is to report compensation already received.

The DOL has recognized issues like these and has provided for an extension of the effective date of Final Regulations to January 1, 2012. In this regard, the DOL has stated that the effective date of the Interim Final Regulation has been delayed, “[g]iven the need to ensure a careful review of all the valuable input we received on the interim final rule,” to “ensure that we have the time we need to get the final rule right and that plans and their service providers have the time they need to undertake orderly and efficient compliance efforts following publication of the final rule.”21 Although we greatly appreciate this flexibility, we believe that additional flexibility is necessary and appropriate.

2. **Recommendation**

We recommend that the Final Regulations be effective no earlier than one year from the date they are published in the Federal Register. Alternatively, we recommend that the DOL provide transitional relief through December 31, 2012, if the service provider provides covered plans with a statement that the service provider made a good faith effort and acted with reasonable diligence to comply with the disclosure requirements in a timely fashion, but was not able to complete the required disclosures by January 1, 2012.

3. **Explanation**

As the DOL has recognized, complying with the Final Regulations will be challenging. We believe that our recommendation appropriately balances the need for responsible plan fiduciaries to obtain complete and accurate fee disclosures with the difficulties that service providers are facing in implementing the required changes. We also feel that a delay in the effective date or transitional relief would ultimately increase the scope and quality of compliance in the market.

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