Defending Liberty
Pursuing Justice

Section of Taxation

10th Floor
740 15th Street, N.W.
Washington, DC 20005-1022
202-662-8670
FAX: 202-662-8682
E-mail: tax@abanet.org

CHAIR
William J. Wilkins
Washington, DC
CHAIR-ELECT
Karen L. Hawkins
Oakland, CA
VICE CHAIRS
Administration
Rudolph R. Ramelli
New Orleans, LA
Committee Operations
Peter J. Connors
New York, NY
Communications
Ellen P. Aprill
Los Angeles, CA
Government Relations
Armando Gomez
Washington, DC
Professional Services
Samuel L. Braunstein
Fairfield, CT
Publications
Louis A. Mezzullo
Rancho Santa Fe, CA
SECRETARY
Alice G. Abreu
Philadelphia, PA
ASSISTANT SECRETARY
Brian P. Trauman
New York, NY
COUNCIL
Section Delegates to the House of Delegates
Paul J. Sax
San Francisco, CA
Richard M. Lipton
Chicago, IL
Immediate Past Chair
Stanley L. Blend
San Antonio, TX
MEMBERS
Christine L. Agnew
Washington, DC
John P. Barrie
New York, NY
Peter P. Blessing
New York, NY
Walter Burford
Atlanta, GA
Thomas J. Callahan
Cleveland, OH
William H. Caudill
Houston, TX
Leslie E. Grodd
Westport, CT
C. Wells Hall, III
Charlotte, NC
Thomas R. Hoeker
Phoenix, AZ
Helen M. Hubbard
Washington, DC
Kathryn Keneally
New York, NY
Emily A. Parker
Dallas, TX
Priscilla E. Ryan
Chicago, IL
Stephen E. Shay
Boston, MA
LIAISON FROM ABA BOARD OF GOVERNORS
Lee S. Kolczun
Sheffield Village, OH
LIAISON FROM ABA YOUNG LAWYERS DIVISION
Jackie J. Cook
Detroit, MI
LIAISON FROM LAW STUDENT DIVISION
Cynthia Kahl
Berkeley, CA
DIRECTOR
Christine A. Brunswick
Washington, DC

November 19, 2008

Hon. Bradford P. Campbell
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 Proposed "Service Provider" Regulations Under Section 408(b)(2) of ERISA

Dear Assistant Secretary Campbell:

Enclosed are comments on the proposed "Service Provider" regulations 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,

William J. Wilkins
Chair, Section of Taxation

Enclosure

cc: Hon. Douglas Shulman, Commissioner, Internal Revenue Service
Hon. Donald L. Korb, Chief Counsel, Internal Revenue Service
Hon. Eric Solomon, Assistant Secretary (Tax Policy), Department of the Treasury
Hon. Alan D. Lebowitz, Deputy Assistant Secretary for Program Operations, Department of Labor
Lou Campagna, Chief, Division of Fiduciary Interpretation, Department of Labor
Ivan Strasfeld, Director, Office of Exemption Determination, Department of Labor
Robert Doyle, Director, Office of Regulations and Interpretations, Department of Labor

AMERICAN BAR ASSOCIATION
SECTION OF TAXATION

COMMENTS ON THE PROPOSED "SERVICE PROVIDER" REGULATIONS UNDER SECTION 408(b)(2) OF ERISA

The following comments ("Comments") are submitted on behalf of the American Bar Association Section of Taxation (the "Section") 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 Section's Employee Benefits Committee (the "Committee"). Substantive contributions were made by Joni L. Andrioff, Laura E. Bader, Alden J. Bianchi, Beth J. Dickstein, John J. Jacobsen, Jr., Ellen A. Hennessy, Eric R. Paley, Sara R. Pikofsky, S. John Ryan and Linda K. Shore. The Comments were reviewed by John L. Utz, Vice Chair of the Committee and by Kurt L.P. Lawson, Chair of the Committee. The Comments were further reviewed by Pamela Baker for the Section's Committee on Government Submissions, and by Priscilla E. Ryan, the Section's Council Director for the 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.

Contact: Andrew L. Oringer
(212) 819-8561
andrew.oringer@whitecase.com

Kurt L.P. Lawson
(202) 637-5660
kllawson@hhlaw.com

Date: November 19, 2008

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 "contracting 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." Existing U.S. Department of Labor ("DOL") regulations ("DOL Regulations") promulgated under section 408(b) describe the requirements that must be satisfied for a service arrangement to be considered "reasonable" and for services to be considered "necessary." In addition, guidance is provided in section 2550.408c-2 of the DOL Regulations relating to what constitutes "reasonable compensation."

The proposed amendment to section 2550.408b-2 of the DOL Regulations (the "Proposed Regulation")[2] would add new requirements for a service contract to be considered "reasonable" for purposes of the exemption under section 408(b)(2). In response to requests for comments from the DOL, we recommend, as discussed in greater detail below, that the regulation, when finalized, should:

1. clarify that the section 408(b)(2) disclosure requirements do not apply to services provided to an entity, the assets of which do not constitute plan assets, merely because a plan has made an equity investment in such entity;

2. confirm that the relief provided in other statutory or administrative exemptions continues to exempt prohibited transactions under section 406(a)(1)(C) if the applicable conditions are satisfied;

3. not be effective earlier than the first day of the second calendar year to follow the calendar year in which the final regulation is published in the Federal Register; and

4. as a general matter expressly apply to all types of employee benefit plans, whether in the nature of pension plans or welfare plans (whether insured or uninsured).

---

[1] Unless otherwise indicated, references to a section are to a section of ERISA.

[2] 72 Fed. Reg. 70,988 (Dec. 13, 2007).

COMMENTS

I. BACKGROUND

Section 408(b)(2) provides an exemption from the prohibited transaction rules of section 406(a) for "contracting 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 DOL Regulations describes the requirements that must be satisfied in order for a service arrangement to be considered "reasonable" and for services to be considered "necessary."[3] In addition, section 2550.408c-2 of the DOL Regulations provides guidance relating to what constitutes "reasonable compensation."[4]

The Proposed Regulation would add new requirements for a service contract to be considered "reasonable" for purposes of the exemption under section 408(b)(2). Specifically, under the Proposed Regulation, in order for an arrangement to be considered reasonable, a service-provider must agree to furnish, and furnish in fact, certain information to plan fiduciaries, including (i) all services to be provided to the plan, (ii) direct and indirect compensation to be received by the service-provider, and (iii) information relating to potential conflicts of interest. Failure to satisfy these disclosure requirements could result in the provision of the services being prohibited under section 406(a).

II. DISCUSSION

A. General scope of disclosure obligations

1. Summary

Generally, under section 2510.3-101 of the DOL Regulations, as modified by section 3(42) (the "Plan Asset Regulation"), a plan's equity investment in an entity will cause the assets of the entity to be considered plan assets unless an exception applies. One example of a situation where an exception generally applies is where less than 25% of each class of equity interests issued by the entity is held by "benefit plan investors."[5] Other examples are where the entity is an investment company registered under the Investment Company Act of 1940, as amended (a "RIC"),[6] or a venture capital operating company ("VCOC"), real estate operating company ("REOC") or other type of operating company.[7]

---

[3] 29 C.F.R. § 2550.408b-2(b), (c).

[4] 29 C.F.R. § 2550.408c-2.

[5] 29 C.F.R. § 2510.3-101(f); § 3(42).

[6] 29 C.F.R. § 2510.3-101(a)(2); § 401(b)(1).

[7] 29 C.F.R. § 2510.3-101(c).

It has long been understood that the requirements of ERISA do not apply to an entity the assets of which do not constitute "plan assets" under section 401(b)(1) and the Plan Asset Regulation (a "Non-Plan Assets Entity"), merely on account of such investments. Thus, for example, persons managing a Non-Plan Assets Entity are not fiduciaries of plans that make equity investments in the entity, and persons dealing with the entity are not deemed to be dealing with the investing plans (including providing services to the plans), merely on account of such investments.

However, the preamble to the Proposed Regulation states, without elaboration, that "persons or entities that provide investment management, recordkeeping, participant communication and other services to the plan *as a result of investment of plan assets* will be treated as providing services to the plan."[8] This statement could be read, for example, to treat services provided to Non-Plan Assets Entities as prohibited transactions under section 406(a) unless the requirements of section 408(b)(2) – including the disclosure and other requirements in the Proposed Regulation – are satisfied.

2. Recommendation

We recommend that the final DOL Regulation clarify that the section 408(b)(2) disclosure requirements do not apply to services provided to a Non-Plan Assets Entity, merely because a plan has made an equity investment in such entity.

3. Explanation

We note at the outset the daunting task undertaken by the DOL to update and modernize the DOL Regulations under section 408(b)(2) as properly necessitated by changes in the market over time. As pointed out by the DOL, "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."[9] As we will discuss below, however, the need to consider a revision to the rules does not require that the basic analytical structure that has evolved under ERISA be disturbed, with potentially extensive and unclear results.

As noted above, long-established results of an entity's assets not being "plan assets" include that the persons managing the assets of the entity are not fiduciaries of plans that make equity investments in the entity merely on account of such investments, and that persons dealing with the entity are not deemed to be dealing with the investing plans merely on account of such investments. In our view, these results are critical aspects of the ERISA regulatory scheme that has evolved since 1974 because they permit Non-Plan Assets Entities to operate free of ERISA's "comprehensive and reticulated" requirements.[10] This conclusion is bolstered by section 3(21)(B) and the legislative history to ERISA. Section 3(21)(B) states that a plan's investment in a RIC will not by itself cause the RIC's investment advisor to become a fiduciary with respect to the plan.

---

[8] 72 Fed. Reg. at 70,990 (emphasis added).

[9] *Id.* at 70,988.

[10] *See Nachman Corp.* v. *PBGC*, 446 U.S. 359, 361 (1980).

The conference report to ERISA explains that, "[s]ince mutual funds are [otherwise regulated], it is not considered necessary to apply the fiduciary rules to mutual funds merely because plans invest in their shares."[11]

Clarifying this point was one of the DOL's main goals in issuing the Plan Asset Regulation. The preamble to the final version of that regulation explains that ERISA and its legislative history did not provide comprehensive guidance on "when an investment is an arrangement for the indirect provision of investment management services," and that "if the [DOL] does not adopt a regulation, uncertainty about the scope of the fiduciary responsibility rules will persist until such times as the issue is settled in litigation. The uncertainty would, in the Department's view, be detrimental to plans as well as to persons marketing investments to plans."[12]

As an example of this principle, in the absence of some relationship besides the investments themselves, it has been assumed generally that neither the persons who manage the assets of a Non-Plan Assets Entity, nor those who act as brokers, custodians or administrators for such an entity, are deemed to be service-providers to the plans that invest in such entity. As a result, their activities with respect to the entity are not subject to ERISA, and transactions entered into by these parties are not subject to the fiduciary or prohibited transaction provisions of ERISA.

A result under which a service-provider to a Non-Plan Assets Entity would be considered to be a service-provider to a plan for purposes of the prohibited transaction provisions – or the fiduciary or any other provisions – of ERISA merely because of the plan's equity investment in the entity would mark a new approach in our experience with ERISA, and bring into substantial doubt the utility of an entity's being a Non-Plan Assets Entity.

We do not here address whether the Proposed Regulation should apply to compensation for services to Non-Plan Assets Entities where that compensation is, under all of the facts and circumstances, indirect compensation for services provided directly to a plan that invests in the entity. Thus, for example, our comment does not address a situation where a person providing services to a Non-Plan Assets Entity also provides services directly to a plan that invests in the entity for an independent reason, such as acting as a recordkeeper to the plan, and part of the person's compensation for services provided to the plan is derived from the Non-Plan Assets Entity. However, even in this situation – where the service-provider also provides services directly to a plan investor – we do not believe it is appropriate to treat the compensation received by the service-provider from the Non-Plan Assets Entity as indirect compensation for the direct services unless there is some factual basis for that conclusion besides the investment itself.

We also do not mean to suggest that there could never be a case in which services provided to a Non-Plan Assets Entity would be considered to be "indirect" services

[11] H.R. Conf. Rep. No. 93-1280, 296 (1974), 1974-3 C.B. 415, 469.

[12] 51 Fed. Reg. 41,262, 41,264 (Nov. 13, 1986).

provided to a plan investor. We simply do not believe such a situation exists whenever the services in some sense ultimately benefit the plan. Section 2509.75-2 of the DOL Regulations (formerly Interpretive Bulletin 75-2) has provided appropriate authority regarding this question in the case of certain types of unusual and potentially abusive scenarios. The rules under section 2509.75-2, which were updated in connection with the finalization of the Plan Asset Regulation, have long served as an appropriate and effective framework for the analysis of such questions, and we believe it is appropriate for those rules generally to remain in place and undisturbed, so that they may continue to provide guidance in this regard.[13]

B. Effect on Other Exemptions

1. Summary

The DOL has asked for comment on the extent to which the application of the disclosure requirements contained in the Proposed Regulation will affect, or may be affected by, other ERISA statutory exemptions that may relate to plan service arrangements. The DOL's longstanding position and practice have been that so long as all the conditions of any exemption (statutory, class or individual) have been satisfied, a covered transaction is exempted. In fact, the General Information section to the DOL's administrative exemptions generally contains the statement that granted exceptions are "supplemental to, and not in derogation of," other statutory exemptions and transitional rules.

2. Recommendation

We recommend that the final DOL Regulation confirm that the relief provided in other statutory or administrative exemptions continues to exempt prohibited transactions under section 406(a)(1)(C) if the applicable conditions are satisfied.

3. Explanation

The longstanding DOL policy noted above remains essential to the efficient administration of ERISA. We do not believe that the final DOL Regulation should affect any of the other statutory exemptions, since each one appears to us to stand alone and operate independently. The same result would seem to obtain with respect to administrative exemptions, at least until those exemptions are themselves revised or withdrawn. For example, Prohibited Transaction Class Exemption ("PTE") 84-14, as

[13] The final version of the Plan Asset Regulation explains that, while under section 2509.75-2 the DOL "would consider a fiduciary who makes or retains an investment in a corporation or partnership for the purpose of avoiding the application of the fiduciary responsibility provisions of the Act to be in contravention of the provisions of section 404(a) of the Act," nevertheless "it is the [DOL's] view that the mere fact that a fiduciary makes or retains an investment in a corporation or partnership which does not hold plan assets under the [Plan Asset Regulation] does not mean the fiduciary has engaged in a transaction for the purposes of avoiding the application of the fiduciary responsibility rules within the meaning of the final paragraph of [section 2509.75-2]."

amended ("PTE 84-14") provides relief from the prohibited transaction provisions of section 406(a)(1)(A) through (D) for most transactions entered into on behalf of a plan by a "qualified professional asset manager" (a "QPAM"). To qualify as a QPAM, an entity must be a bank, a savings and loan association, an insurance company or a registered investment adviser and must also have substantial client assets under management. Since the relief provided by PTE 84-14 is based on the concept that a QPAM is an "established institution large enough to discourage the exercise of undue influence upon their decision making process," it would seem that such entities would also be able to determine what information is necessary in negotiating the terms of a "reasonable contract or arrangement" without the DOL's guidance. We believe it would be inappropriate for the final DOL Regulation to overturn the transactions that have been entered into in reliance on longstanding DOL guidance.

C. Effective Date

1. Summary

The DOL has proposed "that its amendments to regulation section 2550.408b-2(c) be effective 90 days after publication of the final DOL Regulation in the Federal Register." The Proposed Regulation would impose sweeping new contract requirements on plans and service-providers alike. The typical plan is presently engaged in multiple service relationships. Experience tells us that, while many of these relationships are memorialized in written agreements, many are not. Experience also tells us that for those relationships that are already memorialized in written agreements, few if any of those agreements reflect the detailed level of disclosure demanded by the Proposed Regulation. Therefore, once the Proposed Regulation is finalized, it is fair to assume that a responsible plan fiduciary will need to review each of its service relationships with an eye toward securing a compliant written contract, if not negotiating a new written contract where none existed previously. Even in the best of circumstances with all parties fully engaged, it is unrealistic to expect that this process can be completed within a 90-day period.

2. Recommendation

We recommend that the final DOL Regulation be effective no earlier than the first day of the second calendar year to follow the calendar year in which it is published in the Federal Register.

3. Explanation

We believe that a delay consistent with our recommendation would appropriately balance the need for responsible plan fiduciaries to secure clear, accurate disclosures of the fees that plans and their participants are paying for plan-related services with the practical exigencies those same fiduciaries face in securing compliant arrangements with each of their service-providers. We feel that a period extended beyond the one presently proposed by the DOL would ultimately increase the scope and quality of compliance in the market.

D. Scope of the Rules

1. Summary

Fiduciaries must act for the exclusive benefit of participants and beneficiaries, and observe ERISA-mandated fiduciary standards in all employee benefit plans, whether denominated as "pension" or "welfare." The preamble to the Proposed Regulation makes clear that the disclosure requirements would apply regardless of whether a plan is a pension plan, group health plan or other type of welfare benefit plan. However, we understand that some comments have suggested that this requirement apply to welfare plans on a more limited basis or not at all.

2. Recommendation

We recommend that the final DOL Regulation as a general matter apply to all types of employee benefit plans, whether in the nature of pension plans or welfare plans (and whether insured or uninsured).

3. Explanation

Welfare plans, particularly large self-funded medical plans, rely on a host of service-providers to operate. These may include actuaries, accountants, lawyers, third-party claims administrators, pharmacy benefits managers, "COBRA" administrators and stop-loss carriers/reinsurers, among others. We believe that the possibility of indirect compensation and conflicts of interest sometimes exists in this context, and that when it does information about them can be as useful to plan fiduciaries as it is in the pension investment context. However, we recognize that applying the requirements to welfare plans might raise more interpretive issues, such as when service providers are providing services to the plan or to the service provider itself, rather than merely to plan participants, and believe that the DOL should fully explore these nuances in connection with issuing final regulations.