Proskauer

# Investment Advisers to Plans May Be Required to Deliver "Disclosure Guide" Under ERISA

**April 10, 2014**

On March 12, 2014, the U.S. Department of Labor (the DOL) issued a proposed amendment (the Proposed Amendment) to its final regulations (the Final Regulations) under Section 408(b)(2) of ERISA (commonly referred to as the "necessary services exemption") which would require covered service providers to furnish a "guide" to assist plan fiduciaries in reviewing the initial disclosures required by the Final Regulations, *but only if the required initial disclosures are contained in multiple or "lengthy" documents* (the text of the Proposed Amendment may be accessed here).

**Background**

Under the Final Regulations (which became effective July 1, 2012), "covered service providers" (e.g., investment advisers to ERISA-covered pension plans and private investment funds deemed to hold the "plan assets" of ERISA-covered pension plans) must disclose to "covered plans" (e.g., ERISA-covered pension plans) certain information regarding the services they provide and the compensation they receive.

Investment advisers to ERISA-covered pension plans (either directly or as investors in funds deemed to hold plan assets) rely on the "necessary services exemption" under Section 408(b)(2) of ERISA to provide investment-related services to ERISA-covered pension plans for compensation without engaging in a non-exempt "prohibited transaction" under ERISA or the Internal Revenue Code. Unless another exemption is available, failure to comply with the Final Regulations could lead to a non-exempt prohibited transaction, the penalties for which can include the imposition of excise taxes and a refund of compensation.

Investment advisers to private investment funds that are not deemed to hold plan assets under ERISA (e.g., funds that (i) restrict "benefit plan investor" participation to less than 25% of the value of each class of equity interest in the fund (generally excluding for these purposes commitments held by the fund's sponsor and investment adviser and their affiliates), and/or (ii) qualify either for the venture capital operating company (VCOC) or real estate operating company (REOC) exception) generally are not subject to the disclosure requirements under the Final Regulations (and, therefore, would also not be subject to any new guide requirement under the Proposed Amendment) with respect to such funds or investors in such funds.

**The Final Regulations**

The initial disclosures required by the Final Regulations include, among other items:

- a description of the services to be provided by the covered service provider;
- a description of the direct and indirect compensation to be received by the covered service provider and the manner in which it will be received;
- a statement as to whether the covered service provider reasonably expects to provide services as an ERISA fiduciary or a registered investment adviser; and
- for an adviser to a private investment fund deemed to hold plan assets, certain additional investment-related information (e.g., the annual operating expenses).

The Final Regulations require that the initial disclosures be made reasonably in advance of the date on which the applicable investment management or advisory contract or limited partnership agreement is entered into, extended or renewed. In addition, there are special disclosure timing rules in certain situations, including when non-plan asset funds become plan asset funds.

The Final Regulations do not require the disclosures to be made in any particular manner or format. In fact, the preamble to the Final Regulations specifically noted that covered service providers could use different documents from separate sources, provided that all of the documents collectively contain the required disclosures. The DOL did include a "sample guide" as an appendix to the Final Regulations, which the DOL encouraged, but did not require, covered service providers to use (the sample guide may be accessed here by scrolling to the bottom of the Final Regulations). The DOL noted its intent to publish, in a separate proposal, a guide or similar requirement to assist plan fiduciaries' review of the required disclosures.

For a more detailed summary of the Final Regulations, please see our earlier client alerts here and here.

**The Proposed Amendment**

Based on its reviews of service providers' disclosures and plan fiduciaries' experiences in reviewing those disclosures, the DOL determined that a "guide" requirement would assist plan fiduciaries (especially fiduciaries to small and mid-sized plans) in their reviews of the required disclosures (which the DOL views as an important part of satisfying their fiduciary duties).

Accordingly, the DOL has proposed that covered service providers who make their disclosures through multiple or "lengthy" documents must furnish a separate written "guide" to those documents. The DOL has requested comments on what number of pages would be considered "lengthy" for these purposes. A separate written guide would not be required under the Proposed Amendment to the extent the initial disclosures are provided in a single document that is not considered "lengthy".

If the guide is required, the Proposed Amendment requires that it must specifically identify the document and page number, or use some other "sufficiently specific locator" (e.g., a section reference), that enables the responsible plan fiduciary to quickly and easily find the required initial disclosures applicable to the contract or arrangement. The guide must also identify a person or office (including contact information) that the responsible plan fiduciary may contact regarding the disclosures. The guide must be furnished along with the required initial disclosures but must be set forth in a *separate* document. Changes to the information contained in the guide must be disclosed at least annually.

The DOL did not provide a "model guide" in the Proposed Amendment but did once again refer covered service providers to the "sample guide" (which was included as an appendix to the Final Regulations) as a helpful example.

The Proposed Amendment would become effective twelve months after publication of a final rule in the *Federal Register*, so there will be some time to adjust to the new guide requirement if finalized.

The DOL has requested comments on all aspects of its proposal (e.g., the specific elements of the guide, as well as whether to even require a guide at all or some alternative tool, such as a summary of key disclosures), which are due June 10, 2014.

The DOL also announced its intention to conduct focus group sessions with fiduciaries to small pension plans (those with fewer than 100 participants) to explore current practices and effects of the Final Regulations and the need for a guide, summary or other similar tool to assist plan fiduciaries in navigating and understanding the required disclosures. The DOL noted that it would release the results to the public after the testing has been completed.

A few items to note:

- First, the Proposed Amendment expressly requires that the guide be provided as a "separate" document. Accordingly, unless revised or clarified, the Proposed Amendment would presumably prohibit a covered service provider from including the guide as an exhibit or attachment to another document (e.g., as an exhibit or attachment to a subscription agreement or an investment management agreement).

Second, it is not clear whether the guide requirement will only apply on a prospective basis (i.e., to contracts or arrangements entered into, renewed or extended after the effective date of the finalized amendment) or to existing arrangements as well. Accordingly, it is possible that a covered service provider would need to deliver a guide even in situations where it had already sent out 408(b)(2) disclosures in compliance with the Final Regulations. Further, even those covered service providers that have already delivered a form of guide might need to deliver a new one if the original delivery did not comply with the requirements of the Proposed Amendment (e.g., if the original guide was included as an exhibit or attachment to another document and was not provided as a separate document).

- Third, assuming the Proposed Amendment is finalized in its current form, a failure to deliver the guide in accordance with the requirements of the Proposed Amendment would be treated as a failure to comply with the requirements of the ERISA Section 408(b)(2) "necessary services exemption", potentially resulting in a non-exempt prohibited transaction if no other exemption is available.

The foregoing is intended to be a general summary of certain aspects of the Proposed Amendment and the Final Regulations that are most likely to apply to investment advisers providing services to ERISA plans and plan asset funds, and is not intended to be an exhaustive review of the requirements thereunder. If you have any questions regarding the Proposed Amendment, the Final Regulations or this client alert, please feel free to contact any of the Proskauer attorneys listed in this alert.

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