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Happily Ever Afer?

Happily Ever After? – Investment Funds that Live with ERISA, For Better and For Worse (Part Three of Five)

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This is the third article in our five-part serialization of a treatise chapter by Dechert LLP partner Andrew Oringer. The chapter describes the ERISA provisions of chief relevance to private fund managers, and includes references to a wide range of relevant and, in some cases, obscure authority. This third article in the series focuses on prohibited transactions, qualified professional asset managers, the "service provider" exemption and the exemption for compensation for services. The second article in the series covered fiduciary duty considerations, including delegation, allocation of investment opportunities, varied interests of fund investors, indemnification and insurance, investments in portfolio funds, enforcement-related matters and diversification requirements. The first article in the series discussed the "plan assets" rules and rules for the delegation and allocation of fiduciary responsibility.

Prohibited Transactions

<u>Certain General Rules Relating to Transactions with Parties in Interest</u>

When a fund operates subject to ERISA, the related-party prohibited transactions of ERISA Section 406(a) will potentially become applicable.[1] This consideration may have real impact more frequently than one might surmise. A review of the basic scope of ERISA's related-party rules may provide helpful context.

What are the per se prohibitions of ERISA Section 406(a) designed to address? Facially, the provisions of Section 406(a) are intended to apply to related-party transactions: transactions with "parties in interest." They are not, on their face, rules of general application. If the plan is dealing with a person who is not a party in interest, Section 406(a) does not apply. Why, then, are transactions so commonly reviewed for applicability of an exemption? In this regard, managers of Plan Assets Funds frequently make use of one or more 406(a) exemptions, and plan investors inquire about the availability of such exemptions, even when the Plan Assets Fund manager is not seeking to deal with parties related, in a traditional sense, to the plan investors.

This practice would appear to result, at least in part, from Congress's having included in the list of related parties under the "party in interest" definition not only employers, trustees, fiduciaries, and the like, but also persons merely "providing services" to the plan.[2] The trend over time toward consolidation in the financial-services industry,[3] together with the expansive nature of what may potentially be considered "services" for these purposes, means that any given institution may well be providing some service to a wide range of plans.[4] Further, in the case of continuing transactions (loans, certain swaps, and other derivatives, etc.), the question of whether a party-in-interest relationship may develop[5] may also arise, exacerbating the issue.[6]

As a result, a number of large financial institutions (which bear, at a minimum, the excise-tax risk)[7] will effectively proceed on the assumption that they are parties in interest with respect to all plans generally,

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and plan fiduciaries (who bear the risk of liability for a breach of fiduciary duty) may well do likewise.[8] At the same time, a wide range of financial transactions are consummated with those same large financial institutions. The practical effect can be to convert a prohibition with a narrowly targeted intent – to prohibit certain related-party transactions with a plan absent an exemption – into a provision that constrains transactions involving plans generally.

The difficulties engendered by the possibility of party-in-interest prohibited transactions (along with issues that may arise in connection with the structuring of fees, discussed below)[9] are usually among the more significant practical impediments to operating as a Plan Assets Fund. Indeed, even if the manager of a Plan Assets Fund is willing to undertake compliance issues surrounding Section 406(a), some parties may not deal with an entity subject to ERISA, particularly in light of the fact that the burden of excise taxes and other remedies falls on the party in interest.[10]

Qualified Professional Asset Managers

In General

In a number of situations, it will be critical for the manager of a Plan Assets Fund to qualify as a qualified professional asset manager (QPAM) under ERISA Prohibited Transaction Class Exemption 84-14, as amended (QPAM Exemption). Part I(a) of the QPAM Exemption sets forth an exemption and related conditions applicable in the case of certain party-in-interest transactions that would otherwise be prohibited under Section 406(a). The ubiquitous QPAM Exemption can be critical, either because the Plan Assets Fund desires or needs to operate in an ERISA-compliant manner, or because investors may perceive that qualification as a QPAM has value, regardless of whether the relief afforded thereby may actually be needed.[11]

Where QPAM status is sought, the maintenance of QPAM status can be important from the perspectives of both the plan investor and the manager of the Plan Assets Fund.[12] The investor's appointing fiduciary has an interest in ensuring that prohibited transactions do not occur, and the manager has an interest – beyond the evident contractual, relationship, and reputational risks – in not engaging in transactions that are prohibited because the manager has not qualified for QPAM Exemption.[13]

Certain Appointment/Termination Issues

One potential complication in administering the QPAM Exemption is that the party in interest dealing with the plan or its affiliates cannot have or have exercised certain rights regarding the appointment or termination of the QPAM (or the negotiation of the QPAM's management agreement).[14] In the case of collective investment through a Plan Assets Fund, the QPAM Exemption's appointment/termination rule can become unwieldy, as the number of plan investors in the Plan Assets Fund (and the consequent number of parties with appointment/termination rights over the manager of the Plan Assets Fund) grows. In some cases, a Plan Assets Fund may not wish to identify its investors, potentially further complicating the inquiry as a practical matter.[15]

Depending on the composition of a Plan Assets Fund's investors, however, concerns regarding the appointment/

termination rule may be substantially ameliorated by relief under the QPAM Exemption, indeed possibly to the point that collective investment facilitates rather than complicates compliance with the QPAM Exemption. Under an exception contained in the QPAM Exemption (the 10% Exception), the rules relating to whether the party in interest (or an affiliate of the party in interest) dealing with the plan has or has exercised appointment/termination rights do not apply to a plan with a less-than-10% interest in the investment fund managed by the QPAM.[16] The 10% Exception can be extremely useful,[17] especially in light of some of the practical difficulties that might otherwise arise as to the application of the appointment/termination rules.[18]

Under a DOL interpretation of the 10% Exception, the 10% calculation applies only to direct plan investment, enhancing the utility of the exception in multilayered collective-investment contexts.[19] For example, if an upstream Plan Assets Fund invests in a second Plan Assets Fund, the 10% inquiry at the second Plan Assets Fund generally does not take into account any investment by individual plans in the upstream Plan Assets Fund.[20]

Newly Organized Managers

New managers seeking QPAM status may need to consider whether they satisfy the assets-under-management requirement. This requirement generally involves a look back to the end of the prior fiscal year.[21] Notably, in 2005 the DOL expressly declined to clarify the assets-under-management requirement rules to provide flexibility for new managers.[22]

A completely new entity or a new entity that is formed or otherwise emerges in the context of a manager's spin-off or other reorganization may also raise QPAM considerations.[23] As a general matter, where a new manager does not initially qualify as a QPAM, other approaches to avoid prohibited transactions, such as determining that no party-in-interest transaction will occur or that some other exemption applies, may be needed until the manager becomes a QPAM.

20% Concentration Test

One of the requirements of the QPAM Exemption is that the assets managed by the QPAM of the plan with respect to which the exemption is sought (and plans of the same employer (or the employer's affiliates) or employee organization) must not be more than 20% of the total client assets managed by the QPAM at the time.[24] It is worth nothing, in the collective-investment context, that this test is a manager-by-manager test, not a fund-by-fund test.

The "Service Provider" Exemption; Certain Corrections

Transactions with Mere Service Providers

A significant development regarding the rules governing prohibited transactions is the addition of statutory exemption for transactions with mere service providers under ERISA Section 408(b)(17). ERISA now clarifies that a transaction for "adequate consideration" with a party in interest by virtue of being a service provider or affiliate thereof is not prohibited if the transaction is not with a fiduciary with respect to the assets involved in the transaction or an affiliate of such a fiduciary.[25]

There are those who [ultimately] rely on Section 408(b)(17) as a basis on which to proceed. However, notwithstanding Congress's effort to facilitate the consummation of transactions between plans and mere service providers through the "service provider" exemption, there is a lack of developed definitions as well as other technical issues that arise in applying the exemption.[26] Still, even for parties concerned about applying the Section 408(b)(17) exemption as a planning matter, the exemption appears to provide a useful backdrop that allows parties to become more comfortable that a range of transactions may not be prohibited. In particular, the group of fiduciaries with respect to the particular plan assets involved in a transaction is often narrowly circumscribed, thus making it less likely in many cases that a transaction for adequate consideration will fail to qualify for relief under Section 408(b)(17).

A number of special issues may arise for Plan Asset Funds under Section 408(b)(17). For example, it is unclear whether the inquiry regarding the plan assets involved in the transaction looks vertically up to the investors in the Plan Assets Fund (or up multiple levels, in the case of a Plan Assets Fund investing in a Plan Assets Fund). If the inquiry requires looking up the chain, the number of potential fiduciaries increases, and it may be more difficult to ascertain their identities.[27]

As an additional example, one or more investors in a Plan Assets Fund may have institutional directed trustees, and questions may arise regarding whether such a trustee is a fiduciary with discretion over the assets invested in the transaction for Section 408(b)(17) purposes. If a directed trustee is considered a fiduciary for these purposes with respect to the plan assets it holds, Section 408(b)(17) would generally be unavailable with respect to transactions with that institution (and its affiliates). [28] A Plan Assets Fund may also engage in a variety of sophisticated transactions, giving rise to some ambiguity as to whether the transaction is for "adequate consideration." In this regard, however, the DOL has indicated that the concept of "adequate consideration" is flexible enough to cover sophisticated transactions that do not involve traditional and straightforward purchases and sales, such as securities lending.[29]

Corrections

An additional exemption now found in ERISA, relating to corrections, may provide significant levels of additional practical comfort in various situations. ERISA Section 408(b)(20) provides a 14-day correction period for certain prohibited transactions involving "securities" or "commodities" that are discovered after they have occurred. Notably, the definition of "securities" in Section 408(b)(20)(E)(i) may be broader than one might expect, potentially expanding the utility of this exemption. [30]

Exemption for Compensation for Services

In General

When a manager chooses to operate a fund as a Plan Assets Fund, the manager's compensation essentially becomes subject to ERISA. This result derives from the extremely broad reach of ERISA's rules relating to prohibited transactions. In particular, under a circular set of provisions: (i) among the prohibited transactions

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set forth in ERISA Section 406(a) is the "furnishing of . . . services" between a plan and a party in interest,[31] and (ii) as noted above,[32] a provider of services is, merely by virtue of the provision of services, a party in interest.[33]

Nevertheless, because of the exemption found in ERISA Section 408(b)(2), the issues surrounding payment for ordinary-course services historically did not pose a concern as a practical matter. ERISA Section 408(b)(2) provides a prohibited-transaction exemption for "[c]ontracting or making reasonable arrangements with a party-in-interest for . . . legal, accounting, or other services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid therefor." In light of ERISA's regulations,[34] assuming that a responsible fiduciary had determined the reasonability of the provider's compensation,[35] and assuming further the satisfaction of a regulation requiring that the services arrangement be terminable "without penalty to the plan on reasonably short notice under the circumstances,"[36] the statutory Section 408(b)(2) exemption was perceived by some as being virtually self-executing or at least as generally involving easily satisfied conditions.[37]

Terminability

Where parties seek to rely on ERISA Section 408(b)(2), the express reference to a plan's ability to terminate the services relationship "without penalty to the plan in reasonably short notice under the circumstances"[38] can be troubling for the manager of a Plan Assets Fund because many managers prefer a long-term retention. Further, depending on the type of fund, the manager may request, sometimes without significant protest from investors (other than as to ERISA matters), a long-term arrangement that provides for limited or no transferability and requires substantial advance notice for withdrawal, withdrawal penalties, or some combination of the two.

While at first blush the terminability requirement may seem troublesome, there is substantial flexibility built into the regulatory language.[39] The language specifically refers to notice that is "reasonably" short "under the circumstances." The regulations add that "[a] provision in a[n] . . . arrangement which reasonably compensates the service provider . . . for loss upon early termination of the . . . arrangement . . . is not a penalty."[40] Relevant circumstances could include the extent to which a withdrawal or other termination is inconsistent with the illiquid nature of the investment portfolio, whether an early termination would prevent the manager from being able to benefit from the ultimate success of the chosen investments (e.g., because hoped-for upside would likely be generated, if at all, substantially after the making of the investment), and similar concerns.[41]

Notwithstanding some flexibility in the regulatory language, however, restrictions on withdrawal or termination raise basic analytical questions. For example, is the regulatory provision one that specifically requires the termination to be reasonable when considered separately, before the rest of the arrangement is analyzed for general reasonableness? Would such an approach essentially elevate the termination aspect of an arrangement into what amounts to a superfactor? Or does the provision exist to force the parties to focus on terminability without otherwise generally affecting the overall reasonableness analysis? Because the precise analytical framework seems unclear, the parties will need to develop their own comfort levels where there are impediments to the plan's ability to end its service relationship with the manager.

It should also be noted that a possible alternative analytical approach could focus on the Plan Assets Fund's right, as opposed to an individual plan's right, to terminate the services relationship. Under such a view, the analysis might center on the reasonableness of the ability of the investors in the Plan Assets Fund collectively to terminate the services of the manager, and, as a related matter, on the extent to which the specifics of the termination provisions (e.g., whether termination is effected on a majority vote, with a unanimous vote or in some other manner) allow for the termination of the manager as a practical matter.

Disclosure

Recent changes to the regulations under ERISA Section 408(b)(2), in addition to retaining the terminability provisions,[42] add another layer of requirements relating to disclosure. In general terms, a service provider seeking to be covered by the Section 408(b)(2) exemption needs to disclose to plan investors certain information regarding compensation.[43] In certain cases, the provision of services through a Plan Assets Fund, other than in a direct relationship, may lessen the otherwise applicable disclosure requirements.[44] Unlike the rules applicable for purposes of IRS/DOL/PBGC Form 5500, Schedule C,[45] the Section 408(b)(2) requirements, by virtue of the Code's excise-tax provisions and ERISA's remedies,[46] can have direct applicability to and impact on the service provider.[47]

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[1] In a different context, in connection with the issuance of ERISA §408(b)(2) regulations relating to compensation for services, the DOL considered whether certain prohibited-transaction rules apply to effectively indirect transactions between plan investors in funds that do not hold plan assets and parties dealing with such funds. In contrast to its approach for purposes of Form 5500, the DOL declined to extend the prohibited transaction rules

at issue to that context. Compare 75 Fed. Reg. 41,600, 41,601 (July 16, 2010) (relating to compensation for services), with U.S. Department of Labor, Employment Benefits Security Administration, FAQs About the 2009 Form 5500 Schedule C, Q&As 3-4, 7 (confirming the reach of the IRS/DOL/PBGC Form 5500 rules to "investment funds"). See also 29 C.F.R §2509.75-2(c) (specifying certain narrow instances in which there may effectively be a look-through in the case of an entity not holding plan assets). See generally American Bar Association, Section of Taxation, Comments on the Proposed "Service Provider" Regulations Under Section 408(b)(2) of ERISA (Feb. 29, 2008) (the ABA §408(b)(2) Letter), §II(A).

[2] ERISA §3(14)(C).

[3] See, e.g., 76 Fed. Reg. 15,058, 15,059 (Mar. 18, 2011) ("Many entities in the financial services industry have faced severe economic hardship. During this period of upheaval, the recent trend of industry consolidation amongst significant banks, broker-dealers and other providers of financial services has accelerated.").

[4] To the extent that the investors in a particular Plan Assets Fund remain undisclosed to its counterparty, determining whether a counterparty is a party in interest could become further complicated as a practical matter.

[5] The relationship could develop as a result of a new services-related retention, as a result of a corporate transaction on the provider side, as a result of a corporate transaction on the seller side, etc. Note also that, for example, a party that is a 10% investor in a 50% subsidiary of certain parties in interest would seem itself to be a party in interest under a strict reading of §3(14)(G) and (I). See also American Bar Association, Section of Taxation, Comments on the New Service Provider Exemption Under Section 408(b)(17) of ERISA, added by the Pension Protection Act of 2006 (Feb. 29, 2008) (the ABA §408(b)(17) Letter), §F (discussing the 10%/50% issue in the context of §408(b)(17)).

[6] Certain exemptions may generally allow a continuing transaction eligible for relief to be effectively tested once at inception. Compare Proh. Trans. Class Exempt. 84-14, §V(i), with ERISA §408(b)(17). See also ABA §408(b)(17) Letter, §B. See generally 68 Fed. Reg. 52,419, 52,423 (Sept. 3, 2003). However, even where the continuing-transaction doctrine is used in an exemption, analytical issues may nevertheless arise, for example, in cases in which one or both parties have a termination right involving renewals or other extensions.

[7] In some cases, an institution may ask that compliance allowances run directly from the manager, for example, in light of concerns that a plan or Plan Assets Fund might not be required by a court to pay a party in interest's taxes or other damages arising in connection with a prohibited transaction.

[8] ERISA §406(a) uses a "knows or should know" standard for fiduciary conduct, thereby potentially providing for some measure of protection for the fiduciary when transactions are unexpectedly with related parties. See also §408(b)(20) (relating to corrections of certain otherwise prohibited transactions). In practice, however, the standard may be of limited utility in the market, since the companion provisions of §4975(c)(1)(A)–(D) of the Code contain no such qualifier.

[9] See "Happily Ever After? – Investment Funds that Live with ERISA, For Better and For Worse (Part Four)," nn.1-14 and accompanying text. Some managers may view the scope of permissible indemnification as a material business issue.

[10] See Part One, nn.19-20 and accompanying text. There could be other potentially material considerations. For example, there may be issues regarding breadth of indemnification, see Part Two, nn.16-22 and

accompanying text; an expanded group of potential plaintiffs and other modes of enforcement, see Part Two, nn.26-27 and accompanying text; and issues relating to custody, bonding, and reporting, see Part Five, nn.5-49 and accompanying text. Depending on the facts and circumstances, many managers, particularly those with a significant desire to minimize investments from ERISA plans, may find it easier to live with such issues.

[11] For example, a Plan Assets Fund may focus on trading in public equity securities, where §406(a) prohibited transactions may be less likely to occur. See Part One, n.30.

[12] While not the focus of the discussion contained generally herein, moving from a fund that does not hold "plan assets" to a Plan Assets Fund could raise issues under the QPAM Exemption, since the QPAM Exemption requires an acknowledgment of fiduciary status, and presumably there will be transactions in the transitioning fund affected at a time at which there was no fiduciary relationship between the manager and the investor (and no acknowledgment thereof). It would be hoped that the acknowledgment requirement would not be interpreted in a counterintuitive manner so as to act as an impediment to an otherwise compliant transition.

[13] Arguably, issues with potentially improper delegations to "investment managers," see supra nn.1-6 and accompanying text, may not necessarily arise in securing QPAM status, and it is not clear that a manager needs to be a properly appointed "investment manager" under ERISA in order to serve as a QPAM.

[14] See QPAM Exemption, Pt. I(a) (clauses (1), (2)).

[15] See also supra n.4.

[16] See QPAM Exemption, Pt. I(a) (flush language immediately after clause (2)). In the case of 10%-or-more plan investors, one could look to the QPAM Exemption inclusive of the appointment/termination requirements or could seek some other method of avoiding nonexempt prohibited transactions.

[17] Part I of the QPAM Exemption does not extend to §406(b), see DOL Adv. Op. 2011-06A (Feb. 4, 2011), and thus action by the QPAM that benefits the sponsor of an investing plan (or another plan decision-maker or an affiliate of either) could theoretically raise §406(b) issues, see 29 C.F.R. §2550.408b-2(f) (ex. 5), notwithstanding the application of the 10% Exception. Absent actual self-dealing, however, §406(b) should not be interpreted in this manner, since such an interpretation would arguably run counter to the thrust of the 10% Exception and the facilitation of the operation of a QPAM-managed fund.

[18] For example, it may not be clear who the affiliates of the party in interest are, particularly in light of the potentially expansive "affiliate" definition in Part VI(c) of the QPAM Exemption that is applicable for these purposes.

[19] DOL Adv. Op. 2007-02A (Feb. 26, 2007).

[20] The 10% Exception on its face applies only if there are two or more unrelated plans in the investment fund. In this regard, the language in the 10% rule unfortunately seems more similar to the language of the rule, discussed below, relating to direct reporting by certain plan-assets vehicles (which uses a multiplan formulation, see Part Five nn.36-40 and accompanying text) than to the 10% language used in PTCE 90-1 or PTCE 91-38 (which does not). While at first blush it might seem that a Plan Assets Fund could not have only a single less-than-10% investor and yet reach the 25% limitation so as to have "significant" participation by benefit plan investors under the Significant Participation Test, it is possible in light of the

class-by-class nature of the Significant Participation Test, see 29 C.F.R. §2510.3-101(f)(1) (first sentence). For example, the 25% limitation could be exceeded where (i) an investing plan has a 10%-or-greater interest in a fund, (ii) there are no other plan investors, and (iii) the plan's interest is in a class of equity that is held only by the investing plan.

[21] See QPAM Exemption, Pt. VI(a)(4).

[22] 70 Fed. Reg. 49,305, 49,308 (Aug. 23, 2005) (stating, in light of a comment "that it is difficult for newly-formed entities to satisfy [the assets-under-management] test" (and a related request that such an entity instead "be permitted to satisfy the test based on its last fiscal quarter as demonstrated on a quarterly balance sheet"): "The Department notes that the original QPAM class exemption required the QPAM to satisfy the client assets under management standard as of the last day of its most recent fiscal year to ensure that entities serving as QPAMs are established financial institutions which are large enough to discourage the exercise of undue influence upon their decision-making processes. Therefore, the Department has determined not to revise this condition.").

[23] See DOL Adv. Op. 99-11A (Aug. 20, 1999); see also, e.g., Proh. Trans. Ind. Exempt. 2001-33, 66 Fed. Reg. 46,825 (Sept. 7, 2001).

[24] QPAM Exemption, Pt. I(e).

[25] ERISA §408(b)(17).

[26] Those who are reticent to proceed in reliance on ERISA §408(b)(17) may have to address a range of practical issues in the case of new managers who may have difficulty qualifying as a QPAM, see supra nn.16-18 and accompanying text, or in other cases where the QPAM Exemption or some other sought-after exemption is plainly unavailable.

[27] See generally ABA §408(b)(17) Letter, §D. Similar issues may arise with respect to the QPAM Exemption. See supra n.11 and accompanying text.

[28] See generally ABA §408(b)(17) Letter, §C.

[29] See 71 Fed. Reg. 63,786, 63,795 (Oct. 31, 2006).

[30] For the definition of "securities" used under ERISA §408(b)(20)(E)(i), see I.R.C. §475(c)(2).

[31] ERISA §406(a)(1)(C).

[32] See Part II, n.24 and accompanying text.

[33] As a result of these provisions, ERISA may be seen as effectively subjecting compensation for services to the statute's prohibited-transaction rules in all cases. Arguably, the very first retention of a provider that is not otherwise a party in interest might not be subject to such rules, but even if that argument were successful, the issue would arise again if and when the arrangement is renewed. See Brock v. Gerace, 7 Empl. Benefits Cas. (BNA) 1713, 1715 (D.N.J. Apr. 17, 1986) ("Succinctly stated . . . , the government's position is that the plan's initial agreement with a service provider creates the 'party-in-interest' status and that any subsequent agreements between the plan and these parties, even routine renewals of existing agreements, fall within the reach of Section 406(a) . . . ."); see also UFCW Local 56 Health & Welfare Fund v. Brandywine Operating P'ship, 36 Empl. Benefits Cas. (BNA) 1,400, 1,403 (D.N.J. Oct. 28, 2005) ("To be a 'person providing services' under Section [3](14)(B), a party must have a relationship with the pension plan that preexists, or is independent of, the relationship created by the allegedly prohibited transaction. This interpretation is consistent with the surrounding text of the statute which clearly appears to contemplate a preexisting or independent relationship with the plan, for example, as an officer of the plan, an employer whose employees are covered by the plan, or a controlling shareholder.")

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(citation omitted). Indeed, in the case of all compensation paid after the commencement of the services relationship, the parties could face §406(a) issues even before a renewal. As a practical matter, then, it may well be generally advisable for plan fiduciaries and service-to-service providers to attempt to ensure that compensation arrangements always satisfy an exemption.

[34] 29 C.F.R. §2550.408b-2. Citations to the ERISA §408(b)(2) regulations in this §IV(D)(1) and in §IV(D)(2) are to the regulations before the amendment at 75 Fed. Reg. 41,599 (July 16, 2010).

[35] Indeed, some might argue that objective reasonability of the compensation is sufficient, regardless of whether a responsible fiduciary made any decisions. See generally Harley v. Minn. Mining & Mfg. Co., 284 F.3d 901, 909 (8th Cir. 2002).

[36] 29 C.F.R. §2550.408b-2(c).

[37] Cf. 75 Fed. Reg. at 41,601 ("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.").

[38] 29 C.F.R. §2550.408b-2(c).

[39] See 75 Fed. Reg. at 41,618 ("[O]ne commenter suggested that the Department more definitively delineate time frames for service contracts or notice provisions. . . . 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.").

[40] 29 C.F.R. §2550.408b-2(c). The regulation goes on to state that, "[f]or example, a minimal fee in a service contract which is changed to allow recoupment of start-up costs is not a penalty."

[41] Such factors could distinguish a retention that is reasonable under the circumstances from one in which the manager simply wishes to require a long retention for its own sake.

[42] 29 C.F.R. §2550.408b-(c)(3).

[43] See generally 29 C.F.R. §2550.408b-2(c)(1).

[44] See 29 C.F.R. §2550.408b-2(c)(1)(iii)(A)(2) (enumerating services covered by certain disclosure requirements, stating that "a direct equity investment does not include investments made by the investment contract, product, or entity in which the covered plan invests."). In addition, the use of a feeder in some cases could further diminish disclosure obligations that may otherwise arise at the master level under §408(b)(2). See generally Steven W. Rabitz & Andrew L. Oringer, "Is That Your (Interim) Final Answer? New Disclosure Rules Under ERISA To Impact Many Hedge Funds," The Hedge Fund Law Report, Vol. 3, No. 33 (Aug. 20, 2010).

[45] See generally Part Five, n.41 and accompanying text.

[46] See Part One, nn.19 and 20.

[47] The §408(b)(2) regulation as amended is part of a multipronged initiative by the DOL to increase transparency regarding fees and otherwise increase the level of fee disclosure. Other aspects of this effort include a revamping of the Form 5500 Schedule C, see Part Five, nn.41-43 and accompanying text, and the issuance of regulations governing disclosure to participants in participant-directed account plans, e.g., 29 C.F.R. §2550.404a-5. See generally Another Piece of the Extended Puzzle: Proposed DOL Regulations Reach to General Prudence Rules, posting of Andrew Oringer to BNA Pension & Benefits Blog, Bloomberg BNA Pension and Benefits Blog (July 24, 2008, 13:26 EST).