

## Proposed Regulation on 408(b)(2) “Guide” – Impact on Service Providers

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The **Department of Labor** has issued its long-anticipated proposal to amend the 408(b)(2) regulation. If adopted, the proposal will require covered service providers to furnish responsible plan fiduciaries (referred to as “plan sponsors” for simplicity) with a guide to their disclosures.

This Alert discusses the proposed regulation and its impact on the four major categories of covered service providers: recordkeepers; broker-dealers; registered investment advisers (RIAs); and third party administrators (TPAs).

The guide, as described in the DOL’s proposal, would be a short (probably one or two page) index to the disclosures required by the 408(b)(2) regulation that became effective in 2012. The DOL explains the purpose of the guide in the preamble to the proposal:

*The Department believes that plan fiduciaries, especially in the case of small plans, need a tool to effectively make use of the required disclosures. The guide being proposed in this document provides clarity and specificity,...*

*...Anecdotal evidence suggests that small plan fiduciaries in particular often have difficulty obtaining required information in an understandable format, because such plans lack the bargaining power and specialized expertise possessed by large plan fiduciaries. Therefore, the Department anticipates that the guide requirement will be especially beneficial to fiduciaries of small and medium-sized plans.”*

The DOL is concerned that some covered service providers are using lengthy or multiple documents

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for their disclosures, making it difficult for small- and mid-sized plan sponsors to review those documents and find the essential terms of the service arrangement (the “kernels” of disclosure). The DOL describes its rationale for having the service provider prepare the guide as follows:

*The Department believes that covered service providers are best positioned to provide the guide in a cost-effective manner, because they have the specialized knowledge required to determine where the required disclosures are located, and they generally will be able to structure their disclosures so that they need to locate the information only once when preparing guides for large numbers of clients, each of whom otherwise would have to locate the information separately in the underlying disclosures. A guide will assist responsible plan fiduciaries for these plans in finding information that ERISA requires them to assess in evaluating both the reasonableness of the compensation to be paid for plan services and potential conflicts of interest that may affect the performance of those services. A guide will also reduce the costs they [plan fiduciaries] otherwise would have incurred searching for such information.*

In essence, the DOL believes that the covered service providers are in a better position to identify where the disclosures are being made—both because of their expertise and knowledge and because of the assumed commonality of their disclosures (that is, the DOL anticipates that the disclosures will be similar from one plan to the next, which may not always be the case).

## Summary of the Proposal

The proposed regulation is brief...less than four typewritten pages. However, the regulatory package is not; it is 54 pages long, including an extensive preamble.

The DOL proposes to add a new section to the regulation (section 2550.408b-2(c)(1)(iv)(H)), entitled “*Guide to initial disclosures.*”

1. The requirement for the guide would not apply to all covered service providers. As the proposal explains, the guide would only be required if the disclosures are “not contained in a single document or if the document is in excess of [RESERVED] pages.” In other words, if the disclosures are made in a single, relatively short document, no guide would be required. The DOL has requested comments on the appropriate length of the document, and the regulation will be amended to insert a specific number of pages. (For purpose of this Alert, we will assume that “lengthy” is defined to be more than 15 pages—but this is just a guess and used for convenience.) Because of that, the impact will vary significantly in terms of its impact on the four major categories of covered service providers.
2. The guide would need to be provided together with the initial 408(b)(2) disclosures. It would specify the document name and page number (or “other sufficiently specific locator, such as a section”) for each disclosure to enable fiduciaries “to quickly and easily find the... information required by the 408(b)(2) regulation.” This concept of a “**specific locator**” may be the difficult and controversial provision in the proposal . . . at least for some covered providers.
3. The items to be covered in the guide are:

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- The services to be provided to the plan.
    - A statement of whether services are being provided as an ERISA fiduciary and/or as an RIA.
    - The description of all “direct” compensation.
    - The description of all “indirect” compensation.
    - The description of any compensation that is being paid among “related” parties.
    - The description of any compensation for termination of the contract.
    - The description of all compensation and/or a reasonable estimate of the cost to the plan for recordkeeping services.
    - For certain service providers, the description of required information about the investments.

Each of these bullet points refers to a specific subsection of the 408(b)(2) regulation which describes the disclosure requirements in detail.

4. The guide must “identify a person or office, including contact information, that the responsible plan fiduciary may contact regarding the disclosures provided” by the guide.
5. The guide must be a “separate document.” That is, it cannot be a part of the other 408(b)(2) disclosure documents.
6. And finally, if there are any changes to the information provided in the guide, they must be disclosed at least once per year. In the preamble, the DOL explains its belief that periodic disclosures of changes would be more beneficial to plan sponsors, and less burdensome on covered service providers, than “ongoing and sporadic disclosure each time a change to one component of the guide occurs.”

## Impact on Covered Service Providers

As explained earlier, the four major categories of covered service providers are recordkeepers, broker-dealers, RIAs and TPAs. (For purposes of this Alert, when we refer to TPAs, it means compliance-only TPAs... and not recordkeepers. Also, TPAs are only covered service providers when they receive “indirect” compensation. If a TPA receives indirect compensation, it is most often because the provider is affiliated with an insurance company or a mutual fund complex, and a key subsidy is paid to the TPA to help reduce the cost of the TPA’s services.)

We believe the impact on the four major categories of covered service providers will be:

- **RIAs:** There should be little, if any, impact on most RIAs who serve as investment fiduciaries

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for retirement plans. That is because, in our experience, RIAs are making their 408(b)(2) disclosures in their service agreements, and those service agreements are usually less than 15 pages long. In that case, there would not be a requirement for a guide. However, some RIAs may be making disclosures through multiple documents, for example, through a service agreement and the ADV Part 2. In those cases, the RIAs would need to create a 408(b)(2) guide for their disclosures. Alternatively, they could consolidate their disclosures in the service agreement, without using the ADV.

- **TPAs:** Similarly, most TPAs make all of their 408(b)(2) disclosures in their service agreements, which are usually less than 15 pages. As a result, most TPAs would not need to provide guides. However, some TPAs may be disclosing their indirect compensation payments from insurance companies and mutual fund complexes through a separate document, for example, a brochure. In that case, the TPA would be using multiple documents and would need to either develop a guide or consolidate the disclosures into a single document.
- **Recordkeepers:** In the cases that we have seen (with a few exceptions), recordkeepers are making their 408(b)(2) disclosures with multiple, often lengthy documents. That is because the recordkeepers are required to disclose, in addition to their own compensation, a considerable amount of information about the designated investment alternatives (which may vary significantly from plan to plan). Also, some recordkeepers have both a service agreement and a service manual that describes their services in considerable detail. As a result, we believe that most recordkeepers will need to develop a 408(b)(2) disclosure guide.
- **Broker-dealers:** Broker-dealers will probably bear the greatest burden of compliance with the guide requirement, if it becomes final in its proposed form. It is a common practice for broker-dealers to use multiple documents to make their disclosures. For example, that might include prospectuses for the mutual funds for a 401(k) plan. Alternatively, it might include an account opening form, a service agreement and/or other disclosure document, as well as a reference to the application for a group annuity contract (which could contain the compensation disclosure). Also, the disclosure could include a web page with information about revenue sharing. In those cases, a 408(b)(2) guide would be required by the proposal. We are not aware of any software programs or other automated processes for locating and reporting the necessary information from multiple prospectuses, statements of additional information or insurance applications. As a result, the guide would need to be created manually, which would be difficult and costly, if not bordering on impossible. Because of that difficulty, we believe that most broker-dealers (except perhaps the very largest) will contract with third party service providers to provide 408(b)(2) disclosures (that are in a single, relatively short document).

## Conclusion

The DOL must walk a fine line. The Department is probably correct in its belief that it is difficult – perhaps very difficult – for small plan sponsors to wade through lengthy or multiple documents looking for “kernels” of disclosure. On the other hand, creating and distributing disclosure guides will be expensive and time consuming for broker-dealers and recordkeepers, particularly where the

disclosures are made by reference to multiple documents that vary from plan to plan. The key is the “locator.” Fiduciaries need a quick and easy way to locate the disclosed information. But, particularly for broker-dealers, providing the guide with specific locators may be an expensive undertaking. Hopefully, third-party service providers will help solve that problem.

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National Law Review, Volume IV, Number 79

Source URL: <https://natlawreview.com/article/proposed-regulation-408b2-guide-impact-service-providers>