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The Day After 408b2 Effective Date: What Happens on July 2, 2012?

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The new 408(b)(2) fee disclosure requirements go into effect on July 1, 2012. For the first time since the inception of the Employee Retirement Income Security Act of 1974, a covered service provider[1] ("CSP") will be required to deliver a written disclosure to the responsible plan fiduciary[2] ("RPF") of their status as a fiduciary, the services they will render, fees charged for services rendered and a description of the arrangement between the payer and the CSP.

Once this information is received, the RPF has an obligation to:

1. Read the disclosures,
2. Determine if there are conflicts of interest,
3. Determine if fees are reasonable, and
4. Determine if the disclosures meet the 408(b)(2) regulatory requirements.

Assuming everything is accomplished as required; July 2, 2012 should be uneventful. However, there are three reasons why a fiduciary may find their July 2, 2012 occupied with the preparation of written requests for information from their CSP including:

1. The CSP failed to provide any disclosures,
2. The CSP provided incomplete disclosures, or
3. Additional information is necessary to determine if the contract or arrangement is prudent and/or conflict free.

Failure to Meet the July 1 Deadline:

A fiduciary must take action to secure required disclosures when the CSP fails to provide them on time.

Although a CSP has the legal obligation to provide complete disclosures, the RPF has the legal obligation to demand the disclosures if the CSP fails to provide them by the due date; otherwise, the RPF becomes party to a prohibited transaction. In other words, a RPF is exempt from any liability associated with a prohibited transaction tied to a failure to meet the 408(b)(2) requirements if the RPF takes action to secure complete disclosures when the CSP fails to provide the required disclosures by the required due date. If the CSP fails to provide the RPF with the required disclosures within 90 days of the request, the RPF must report the CSP to the DOL within 30 days and simultaneously begin the process to replace the CSP as expeditiously as possible.[3] According to the regulations, failure to terminate the CSP would be inconsistent with the duty of prudence under ERISA 404(a).[4] Although the regulations are silent as to how much time must past before a RPF

[1] In general, a "covered service provider" is a service provider that enters into a contract or arrangement with the covered plan and reasonably expects $1,000 or more in compensation. 29 CFR 2550.408b-2(c)(1)(iii)
[2] A fiduciary with authority to cause the covered plan to enter into, or extend or renew, the contract or arrangement. 29 CFR 2550.404b-2(c)(1)(viii)(E)

[3] 29 CFR 2550.408b-2(c)(1)(ix)(G); 77 FR 5647-48 (2-3-12)
[4] *Id.,*

inherits liability for the prohibited transaction if the RPF does nothing; it is safe to say that a prudent fiduciary will establish minimal tolerance thresholds when required information is not provided timely by the CSP

To maximize risk mitigation, it is recommended the RPF issue a written request on July 2, 2012 to the CSP that fails to provide the required disclosures on July 1, 2012. The letter requesting the required disclosures does not have to be elaborate an example follows:

LETTER TO A COVERED SERVICE PROVIDER

Dear [Name of CSP]

It is my understanding that I was to receive the required 408(b)(2) fee disclosures on July 1, 2012. As of the date of this letter, those disclosures have not been received. Please send them as soon as possible or let me know if you have no intention of providing the required disclosures. Of course, if you do not believe you are a CSP and; therefore, are not responsible for providing any disclosures please let me know of your reasons why you believe you are exempt from providing the required disclosures.

If I do not receive the required disclosures from you within 90 days from the date of this letter, I will be forced to report you directly to the Department of Labor ("DOL"). In addition, the DOL has stressed in the regulation that should you fail to provide the required disclosure information I must take action to terminate our working relationship as expeditiously as possible. Clearly, it is our preference to avoid this requirement and continue our working relationship, but we do need your help in complying with this legal obligation.

Again, please provide this information as soon as possible or let me know why you believe you are not obligated to comply with this requirement or if you do not intend to comply.

Thank you for your attention to this matter.

Again, a fiduciary that fails to take action to secure the required disclosures risks becoming a party to and personally liable for a prohibited transaction tied to a 408(b)(2) disclosure failure.

Failure to Provide Complete Disclosures

The preamble to the regulation provides us with the criteria a fiduciary must meet in order to enjoy the protection from participating in a prohibited transaction. According to the DOL,

> "The Department does not believe that responsible plan fiduciaries should be entitled to relief provided by the class exemption absent a reasonable belief that disclosures required to be provided to the covered plan are complete. To this end, responsible plan fiduciaries should appropriately review the disclosures made by covered service providers. Fiduciaries should be able to, at a minimum, compare the disclosures they receive from a covered service provider to the requirements of the regulation and form a reasonable belief that the required disclosures have been made." [77 FR 5647-48 (2-3-12)] (Emphasis added)

In other words, a fiduciary must ensure the disclosures are complete. However, to form a reasonable belief such disclosures are complete, the fiduciary should be able to compare the disclosures to the regulations to confirm they are complete.

I think it is fair to say that few employers have internal personnel knowledgeable enough to make that assessment. Of course, when expertise is lacking, a fiduciary has an obligation to seek help from outside experts in order to conduct their fiduciary obligations prudently. The DOL makes this position clear in the preamble as well:

> If the responsible plan fiduciaries need assistance in understanding any information furnished by the service provider, as a matter of prudence, they should request assistance, either from the service provider or elsewhere. *77 FR 5636 (Feb. 3, 2012) (Emphasis added)*

Again, to protect the fiduciary from personal liability associated with participating in a prohibited transaction, they are best advised to secure a professional that is skilled in the assessment of 408(b)(2) compliance to prepare the analysis necessary to form a reasonable believe that all disclosures are complete.

Additional Information is Still Needed!

The new 408(b)(2) disclosures go a long way towards assisting the RPF with their responsibility to ensure that their contract or arrangement with their CSP is reasonable. The new requirements dictate that a RPF receive, what should be, sufficient information to make an informed decision. However, there are two major flaws to the regulation that can only be addressed if additional information is provided by either the CSP or the expert that is assisting with the assessment of 408(b)(2) compliance.

FIRST, the new regulation does not address the issue of relationship. In other words, the disclosure requirements do not assist the RPF with the assessment of conflicts of interest as it relates to the potential family or business relationship between a RPF and CSP. To resolve this potential problem, a RPS should request that all CSPs provide a description of any family or business relationship between them and any RPF that participates in or influences the decision-making process to hire the CSP.[5]

To ensure that a conflict does not occur, a RPF should request from all CSPs a written response to the following:

> *Please provide a written description of your relationship (family or business) with each responsible plan fiduciary and service provider to our retirement plan*.

SECOND, the disclosures provide a RPF with important information to assess the reasonableness of the contract but not the fees charged for services rendered. In fact, it is possible for a CSP to provide all the necessary disclosures and yet fail to charge a reasonable price for services rendered. Clearly, the regulations stop short of demanding a RPF obtain a benchmarking report or engage in an elaborate Request for Proposal ("RFP") process but without either approach, how does a RPF determine if fees are reasonable?

The DOL is on record that a RPF does not have to purchase the lowest cost services[6] and the DOL has never issued a formal statement that would preclude a RPF from hiring the most expensive CSP, which seems to indicate that a RPF has the freedom to make a subjective decision if a process was implemented that supports fees are reasonable for services rendered. Both the DOL and the courts have issued opinions that some type of comparative analysis[7] is appropriate or even necessary to justify a prudent process. In fact, based on a recent court decision, it is pretty clear that hindsight driven arguments to justify reasonableness will not work in the future. At the same time, there is a growing trend among law firms that support benchmarking as a time saving cost effective method to assess fee reasonableness especially if the benchmarking data base is independent of the CSP to avoid compromising its objectivity. Finally, the RFP process is enhanced when combined with benchmarking which cannot be easily influenced by subjective processes, like an RFP.

Clearly, if reasonableness is going to be assessed on a comprehensive cost effective basis, benchmarking solutions, like those offered by PlanTools, are an effective solution.

[5] "Nor may a fiduciary use such authority, control, or responsibility to cause a plan to enter into a transaction involving plan assets whereby such fiduciary…will receive consideration from a third party in connection with such transaction. A person in which a fiduciary has an interest which may affect the exercise of such fiduciary's best judgment as a fiduciary includes, for example, a person who is a party in interest by reason of a relationship to such fiduciary described in section 3(14)(E), (F), (G), (H), or (I)." 29 C.F.R. § 2550.408b-2(e)(1) (Emphasis added)

[6] "The service provider offering the lowest cost services is not necessarily the best choice for your plan." The DOL's ABC PLAN 401(k) PLAN FEE DISCLOSURE FORM

[7] When considering prospective service providers, provide each of them with complete and identical information…so that you can make a meaningful comparison. Meeting Your Fiduciary Responsibilities, page 4; By the DOL (May 2004)