Implications of 408(b)(2) Regulations for Plan Sponsors

Marcia S. Wagner, Esq.

Now that the 408(b)(2) regulations have gone into effect, it is time to consider how a plan sponsor's receipt of the required disclosures by plan service providers affect the sponsor's fiduciary duties under Section 404 of ERISA.

The preamble to the 408(b)(2) regulations explicitly states that a service provider's duty to disclose fees is independent of the sponsor's duty of prudence. It goes on to note that sponsors are responsible for carefully reviewing the information they receive from service providers, and, if they need help in understanding any of it, they must, as a matter of prudence, request such assistance, either from the service provider or elsewhere. If a service provider fails or refuses to provide information requested by a plan fiduciary that would enable the fiduciary to make an informed decision, the DOL's view is that the fiduciary may have a duty to discontinue the service contract or arrangement.

Evaluation of Revenue Sharing

Suppose that a recordkeeper discloses that it may receive five basis points from investment vendors as indirect compensation and that a portion of the indirect compensation may be offset against the direct fees paid by the plan. Although the recordkeeper discloses the direct fee, it explains that it does not have sufficient information to disclose in advance whether or how much indirect compensation it may actually receive in a particular year because the amount is based on the total assets invested by all its clients with the investment vendors. The recordkeeper has complied with its 408(b)(2) obligation to disclose fees, but the plan sponsor does not know how much compensation the recordkeeper will actually receive for its services.

To fulfill its fiduciary responsibilities, the plan sponsor would need to determine the amount of the net direct fee after applying the fee offset. One approach would be to ask the recordkeeper how much of the indirect compensation it received was attributable to the plan. It would then be necessary to compare this figure with the offset applied against the direct fee in order to determine how much indirect compensation was retained by the recordkeeper. The sum of the indirect fee kept by the recordkeeper and the net direct fee would determine the recordkeeper's total fee. The final critical step would be to compare the total fee with the fees charged for recordkeeping services of similar quality and scope in the plan sponsor's market.

Other Hidden Costs

Another example of a hidden cost that must be disclosed to and evaluated by plan sponsors is float revenue, *i.e.*, earnings derived from the short-term investment of plan assets held by a financial service provider pending investment or distribution to a participant. DOL pronouncements, such as the 2009 Frequently Asked Questions regarding reporting on Schedule C of Form 5500, view float as a form of indirect compensation to service providers. In Field Assistance Bulletin ("FAB") 2002-3, the DOL indicated that in order to properly evaluate a service provider's receipt of float, a plan sponsor must consider the qualifications of the provider, the quality of the provider's services, and the reasonableness of the provider's overall fees (including the float) in light of the services. The FAB provides that this process entails a review of comparable providers and service arrangements as to quality and costs, implying that if other providers of the same services would credit float to the plan, engagement of such providers should be considered by the plan sponsor.

The amount of revenue generated by a float arrangement is not easily estimated. The DOL's 2002 FAB instructs plan sponsors to request and review the rates at which float will be earned and to require the terms of a service agreement to specify limits on the periods over which the service provider may earn float so as to enable the sponsor to project the amount of the float. While the DOL acknowledges that this projection is only a "rough approximation," it expects plan sponsors to use it in comparing the arrangement to the float practices of other service providers. Thus, it is not enough for a plan sponsor to determine the estimated float derived from its plan in a vacuum, and it must survey the market to ascertain the amount of float that might be charged by other providers.

ABB Case

The recent case of *Tussey v. ABB, Inc.*, predates the 408(b)(2) regulations, but illustrates the potential liability that exists if a plan sponsor does not adequately utilize the information provided by required disclosures. Among other things, the court held that ABB, the plan sponsor, violated its fiduciary duties by failing to monitor revenue sharing received by the recordkeeper and use it to reduce the cost of providing administrative services to plan participants.

Float was also an issue in the *ABB* case, and the court noted that, had the plan retained this plan asset, its administrative expenses would have been defrayed by such amount and participants would have retained more in their plan accounts. Although the court held that there was no evidence that the plan sponsor was or

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should have been aware of the investment provider's distribution of float income to investment options controlled by the provider and, thus, was not liable for the provider's actions, it did hold that the provider had discretionary control over the float, thereby making the provider a fiduciary. The court further held that the provider used its fiduciary control to retain a portion of the float, thereby resulting in a breach of fiduciary duty and a $1.7 million liability. It should be noted that float recipients that are fiduciaries will be held to a higher standard than other plan vendors.

Lessons for Plan Sponsors

The 408(b)(2) regulations put certain fee information in the hands of plan sponsors, but this may not be adequate to properly evaluate fees, and sponsors may be required to ask for additional information. This can be a cumbersome process when dealing with indirect compensation, fee offsets, and float. The *ABB* case raises the question of whether plan sponsors will have the knowledge and persistence to follow-up with providers to determine the compensation they actually receive.

To ensure that the compensation arrangement with a plan provider is reasonable, sponsors must compare fees from all sources under the arrangement with fees charged by other providers in the plan's market and be prepared to change providers if there is a significant difference in cost, given the quality of services rendered. Financial advisors can assist sponsors with the tasks of analyzing fee information, obtaining supplemental information where necessary, and performing market analyses by such means as industry surveys or competitive bids. The evolution of fiduciary standards requires sponsors to ask for this help if they cannot do these things on their own. ❖

Marcia S. Wagner is the Managing Director of The Wagner Law Group. She can be reached at 617-357-5200 or Marcia@WagnerLawGroup.com.