The Silver Lining in ERISA 408(b)(2)

A comprehensive 408(b)(2) assessment can protect your clients from DOL sanctions or lawsuits.

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I was recently retained by a law firm on behalf of a client that was randomly audited by the Department of Labor. During the audit, the DOL asked the plan sponsor to provide documentation of the assessment they conducted to determine fee reasonableness. The plan sponsor informed the auditor that they had been with their TPA and advisor for many years and that there was no reason to waste their time or incur the expense to benchmark their fees, engage in a Request for Proposal or Request for Information process when they had no intention of leaving their current providers.

Though loyalty is a highly valued characteristic in any industry, the result of the plan sponsor's honest and direct response to the DOL auditor is not what they expected — a demand the plan sponsor reimburse the plan for the past six years of fees deducted from plan assets. Why? Because the plan sponsor failed to provide evidence they had conducted an assessment that their fees were reasonable.

This is not an anomaly but rather validation that the DOL is enforcing the obligations imposed by ERISA §408(b)(2). The bottom line is that ERISA §408(b)(2) imposes new obligations that can be audited, and if it can be audited there must be written procedures established to monitor or enforce compliance. Therein lies the silver lining. New laws that impose new obligations impose new procedures which require new services that justify additional fees. In short, in the words of Louis Pasteur, "fortune favors the prepared mind."

In an era of price compression, charging higher fees for new services may appear to be a message at odds with the trend. However, an enforcement-oriented DOL helps to neutralize the trend of more for less when the consequences for any size retirement plan could exceed the annual fee for compliance by 500% or more. The professionals who embrace this opportunity to step up their deliverables should benefit from these four opportunities:

- higher fees for a service never previously required to existing clients
- compensation for prospecting

- increased market share by demonstrating valued services others don't offer
- increased retention by demonstrating expertise in areas your competitors don't have

Compliance obligations offer the opportunity to expand your business by marketing your knowledge of a complex issue: 408(b)(2) compliance. With regard to 408(b)(2), you must remember that for the first time in the history of ERISA, a Covered Service Provider (CSP) is now obligated to disclose fees in compliance with the regulation. That provision is designed to provide plan sponsors with sufficient information to make informed decisions, identify conflicts of interest and conduct themselves in a prudent manner. All CSPs were required to meet this obligation by July 2012.

While few CSPs failed to meet the legal requirements by July 2012, many failed to provide the Responsible Plan Fiduciary (RPF) with the information they needed to make informed decisions, identify and avoid conflicts and conduct themselves in a prudent manner. Why? Because many CSPs provided their disclosures in lengthy legalese that referenced other documents that turned disclosure obligations into a treasure hunt.

While this may change as a result of the DOL's March 2014 release of amended 408(b)(2) regulations addressing the obligation for a summary of all fees, the obligation to compare fee disclosures to the regulation remains the same. Remember, ERISA §406 makes any relationship with a CSP for services to the plan a prohibited transaction unless you meet the exemption requirements of §408. According to the initial rules:

- fees must be reasonable for services that are necessary for the establishment or operation of the plan; and
- any contract must not lock the plan sponsor in long-term. In other words, it must be a relationship that can be terminated on short notice.

The DOL expanded the requirements effective July 2012 in an effort to provide an RPF with information they need to determine fee reasonableness by requiring a CSP to provide an RPF with specific information. Assuming the RPF has received all the appropriate disclosures, the DOL included in the regulation a description of what they expect an RPF to do with the disclosures. The regulation states:

> *"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."*** ***[Emphasis added]*** *(77 FR 5647-48)*

While it is sometimes challenging to interpret what the DOL expects of a fiduciary, their expectation of the RPF regarding fee disclosure seems clear; yet, the question remains, "Why have so many failed to conduct the assessment?"

Ignorance of the requirement may be one reason, but another may be a failure to use common sense in light of DOL expectations. As Alexander Hamilton outlined so succinctly in the Federalist Papers, "The rules of legal interpretation are rules of common sense, adopted by the courts is the construction of the laws. The true test, therefore, of a just application of them is its conformity to the source from which they are derived. *[No 83 Hamilton, page 495]* To assist with this endeavor, in the accompanying table I have taken the paragraph above and applied a common sense interpretation to it, with the assumption the DOL intends to enforce this obligation with the same vigor I described at the beginning of this article.

The RPF that embraces the risk mitigation relief provided by this exemption will demand a thorough, documented written analysis initially and upon every change to protect the prohibited transaction exemption claim. Unfortunately, very few plan sponsors have the skill, experience and expertise necessary to conduct a thorough comparative assessment of the 408(b)(2) fee disclosures to the regulations with any accuracy or reliability. Thus, this expectation imposes an obligation on an RPF to retain an expert to prepare the assessment.

Since complete disclosures are determined by comparing the disclosures received to the regulations, an RPF must evaluate whether their CSP is capable of producing a comprehensive comparative analysis as required. It should come as no surprise that many CSPs also lack the skill, experience and expertise needed to prepare an adequate comparative analysis.

To avoid making the mistake of retaining a CSP that overpromises and underdelivers, the RPF should request to see a sample of the deliverable before retaining the CSP to conduct the assessment. Failure to ensure all regulatory requirements are covered exposes the RPF to personal risk for monetary damages associated with paying unreasonable fees.

To mitigate this risk and maximize the benefits of this prophylactic, an RPF must confirm that the CSP has the ability to deliver an analysis customized to the plan. If you are a CSP with the expertise to conduct the analysis, you are in a unique position to increase fees and win new business. Keep in mind that there are no shortcuts to this assessment. It requires a detailed comparative analysis.

The free 408(b)(2) checklists I have seen are high-level reviews that do not maximize protection. Use

Preamble to the Regulation	Explanation
"The Department does not believe	The DOL is the administrative office responsible for enforcement. If they don't believe you qualify for the exemption, you have a problem of epic proportions.
that responsible plan fiduciaries	RPF is the person authorized to hire a CSP. This definition first appeared in the amendment to ERISA §408(b)(2).
should be entitled to relief	408(b)(2) provides an exemption from a Prohibited Transaction; you don't get the relief unless you comply!
provided by the class exemption	This is a class exemption, meaning it applies to all plans that meet the requirements. It is not specific to a single plan sponsor.
absent a reasonable belief	"Reasonable belief" as a term has never been used before by the DOL. It needs to be defined, which the DOL did in the following sentence of this paragraph.
that disclosures required to be provided	Disclosures are required. This is not an option. Failure to meet the disclosure requirements requires the RPF report the CSP to the DOL and terminate the CSP relationship.
to the covered plan	A covered plan is the plan to which the disclosures apply.
are complete.	"Complete" is another term first used in the 408(b)(2) regs. The DOL defines what that means in the following sentence.
To this end,	Here comes the close!
responsible plan fiduciaries should	The RPF should. Note it does not say "must," it says "should" — but what are your alternatives?
appropriately review the disclosures	"Review" can be broadly defined to mean appraise, assess, evaluate, examine or to check, study, reread. I believe the definition of "review" is determined by the DOL's description that follows, which indicates a thorough documented process. This is consistent with other fiduciary obligations.
made by covered service providers.	CSPs for the first time in the history of ERISA are required to provide disclosures that meet specific requirements.
Fiduciaries should be able to,	If an RPF is unable to compare the disclosures to the regulations, the RPF does not have sufficient information. Therefore, an RPF must ensure they have sufficient information to be able to compare the disclosures.
at a minimum,	This is the bare minimum, not what may be needed for the RPF to make informed decisions, evaluate conflicts and avoid paying excessive fees. An RPF can do no less than what is required by this minimum.
compare the disclosures	"Compare" is the minimum. Compare the disclosures to the regulations. The DOL does not define how to do the comparison, but at a minimum you must be able to prove you compared the disclosures received to the regulation.
they receive	The DOL makes clear they don't expect you to compare the regulations to something you don't have, although you must demonstrate that you asked for information you knew.

them as a guideline to create your own customize checklist. If you are not comfortable with creating your own comprehensive checklist, hire an ERISA attorney to create one for you — but expect to pay big bucks for the engagement. Alternatively, search the Internet for service providers that have built customized 408(b)(2) checklists. For example, PlanTools' checklists range from eight to 19 pages of questions based upon the services provided by the CSP.

The bottom line: 408(b)(2) requirements can and will be evaluated to determine if the RPF has conducted the appropriate analysis to determined fee reasonableness. Do not be "weighed, measured, and found wanting." (*From "A Knights Tale," Columbia Pictures, 2001*) Use your expertise to your advantage and conduct comprehensive 408(b)(2) assessments at a professional level for your clients to protect them from DOL sanctions or lawsuits. PC

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