Duty Bound

Required reading: 408(b)(2) prohibited transaction rules

On July 1, 2012, a new legal responsibility was imposed on plan sponsors and their fiduciaries—one major example being their plan committees.

That responsibility, or duty, is spelled out in the 408(b)(2) disclosure regulation. But it's not what you think—at least if you are thinking of the fiduciary responsibility as merely to prudently evaluate the services and compensation of your service providers. You have to dig deeper.

Instead, the new duty is found in the 408(b)(2) "prohibited transaction" rules. That duty requires that committees review the disclosures from covered service providers and determine, first, whether the plan received disclosures from all of its covered service providers and, second, whether those disclosures were adequate.

If a committee reviews the disclosures and determines that the plan's covered service providers made adequate disclosures, then there is no prohibited transaction issue. The committee should document that determination in its minutes and then move on to the evaluation of compensation and services.

If the committee determines that disclosures are missing or inadequate, the committee must request that information in writing. If the service provider fails to respond within 90 days or refuses to provide the disclosures, the committee *must* fire the service provider—but allow reasonable time to find a suitable replacement—and report the service provider to the Department of Labor (DOL).

Once the committee has taken those steps, it will have avoided committing a prohibited transaction. On the other hand, if the committee neglects taking those steps, it will have engaged in one. This process raises a couple of important questions:

How do you know which of your service providers are covered by the regulation?

The only safe answer is to seek expert advice, probably from an Employee Retirement Income Security Act (ERISA) attorney. The regulation has a detailed definition of "covered." Absent familiarity with the regulation, it would be difficult to know whether a service provider is covered or not. However, you can safely assume, at the very least, that your adviser and your recordkeeper/bundled provider are covered.

How can the committee know if the disclosures are adequate?

For this purpose, the regulation says that, at the least, the committee needs to compare the disclosures to the regulation and determine whether, on their face, the disclosures are complete.

A good rule of thumb is to review each disclosure and determine whether you can calculate the compensation paid to the service provider from all sources—direct and indirect. If the disclosure enables you to calculate the amount of the provider's compensation, or at least an approximate number, with a high degree of confidence, then you can have some comfort that a disclosure of compensation is adequate for this purpose.

Unfortunately, a number of 408(b)(2) disclosures provide vague or overly broad descriptions of compensation. In such cases, committees should send the "90-day letter" to the service provider, requesting specific information about compensation. And, as mentioned earlier, if the service provider does not supply the information, the committee may be forced to fire and replace the service provider.

The failure to send the request can result in potential liability for committee members. In other words, committees may need to choose between retaining service providers or protecting themselves from liability, as well as obtaining the information needed to fulfill their fiduciary responsibilities.

Fortunately, my experience is that when committees have sent the 90-day letter, the service providers have responded almost immediately with detailed information. As a result, the letter has not resulted in the termination of service providers but instead has provided committees with the information they need to do their job.

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