

June 15, 2012

Two Weeks to Go: Retirement Plan Fiduciaries, Are You Prepared for the New ERISA 408(b)(2) Service Provider Disclosures?

It is just shy of two weeks until July 1, 2012, the deadline by which all covered service providers to qualified retirement plans and 403(b) plans subject to ERISA must provide the fee and service related disclosures under the new Department of Labor (“DOL”) regulations under ERISA 408(b)(2). If you are a fiduciary to a covered retirement plan that has the authority to cause the plan to enter into, extend or renew a service provider’s contract, you are what is known as a “responsible fiduciary.” As though there are not enough duties you have to perform as an ERISA fiduciary, ERISA 408(b)(2) adds a few more and adds some urgency to fulfilling your existing duties related to service contracts and fees. This Client Alert reviews the 408(b)(2) disclosure requirements and provides you as a responsible fiduciary recommendations on actions you can take to comply with your fiduciary obligations.

Under DOL regulations, any contract to provide services to a plan must be reasonable, necessary and for no more than reasonable compensation. The 408(b)(2) regulations are complex but in essence require covered service providers to a covered retirement plan to disclose specific information you can use to help ensure that the plan is paying no more than reasonable compensation for the services provided and to identify potential conflicts in interest arising from the compensation arrangements the service providers have in place with others. **Failure of a covered service provider to provide the 408(b)(2) disclosures is a deemed failure to satisfy the reasonable compensation requirements and results in the covered service provider having engaged in a prohibited transaction under ERISA. In addition, for allowing a prohibited transaction to occur, you may have engaged in a breach of fiduciary duty.**

Who Must Disclose Under ERISA 408(b)(2)?

There are two groups of service providers required to provide fee disclosures:

- Service providers that expect \$1,000 of direct or indirect compensation from a contract or arrangement for services that include any of the following: investment advisory services to plan fiduciaries, fiduciaries under an investment contract or fiduciaries to an investment product or entity that holds plan assets in which the plan holds a direct equity investment. This group could include record keepers, trustee/custodians, investment advisers, fiduciaries, collective investment trusts, etc.
- Service providers that expect \$1,000 of indirect compensation arising from a contract or arrangement for services that include any of the following: accounting, auditing, actuarial, appraisal, banking, consulting, custodial, insurance, participant investment advisory, legal, recordkeeping, brokerage, third party administration or valuation. Indirect compensation is compensation paid for services to a plan from any source other than the plan, the plan sponsor, the service provider or its affiliates and subcontractors. **Note that no disclosure is required from service providers in this group if no indirect compensation is expected.**

What Information Has To Be Disclosed Under ERISA 408(b)(2)?

Very generally, the basic disclosures under the new regulations include:

- The services to be provided (excluding certain non-fiduciary services to an investment contract, product or entity)
- Whether the service provider will provide or reasonably expects to provide services as a fiduciary or as a registered investment adviser
- A description of the direct (if applicable) and indirect compensation the service provider reasonably expects to receive
- If the compensation is set on a transaction basis or charged directly against the plan's investment and reflected in the net asset value of the investment, a description of the compensation paid among the service provider, an affiliate or subcontractor, including the services for which the compensation is charged and the identification of the payers and recipients of the compensation
- A description of the compensation reasonably expected to be received in connection with the termination of the contract and how prepaid amounts will be calculated and refunded to the plan
- A description of the direct and indirect compensation reasonably expected to be received for recordkeeping services, including a good faith estimate of the cost to the plan of recordkeeping services performed without explicit compensation or for which an offset or rebate is used and the methods and assumptions used in preparing the estimate
- A description of the manner in which the compensation will be received
- Disclosures by certain fiduciaries related to investment contracts, products or entities that hold plan assets and in which the plan has a direct equity investment
- For individual account plans, disclosures related to recordkeeping and brokerage services

Clearly the disclosure rules put the burden on a plan's service providers to do the preparation, drafting and distribution work necessary to comply with the rules. However, it is not sufficient for you as responsible fiduciary to just receive the documents sent by the plan's service providers and file them away. There are important actions you should take in connection with these disclosures to protect the plan and comply with ERISA's fiduciary obligations. There are also steps you must take if you do not receive the required disclosures in order to protect yourself from fiduciary liability.

What Actions Should You Take In Connection With ERISA 408(b)(2) Disclosures?

To act prudently, you should consider taking the following actions as part of your compliance with the 408(b)(2) regulations:

- Contact each service provider to the plan and request that the service provider deliver to you the required 408(b)(2) disclosures no later than July 1, 2012. The communication should instruct each service provider to respond, even if the service provider does not believe it is required to do so under the 408(b)(2) regulations. Those service providers that do not believe they are required to provide a disclosure should state the basis for that belief (e.g., they are a provider of legal services that does not receive any indirect compensation related to services for the plan).
- Determine if any service providers did not respond and follow-up with those providers (in the manner described below) so that all service providers are accounted for.

- Determine if the compensation and services disclosed are consistent with the service agreement or other contract between the plan and the service provider. If they are not, address any past discrepancy and correct for future services.
- Determine if the compensation disclosed is reasonable for the services being provided. This may require you to compare the fees paid to its service providers to the fees other providers charge for similar services or to seek guidance from the plan's advisers on what reasonable fees are for the contracted for services.
- Review if there are any disclosed conflicts of interest and if so, determine if they were disclosed prior to the engagement. Also, determine if the conflict is a violation of the service contract or is a prohibited transaction.
- Be sure to revise all service provider contracts to make satisfying the disclosure obligations of 408(b)(2) a requirement of the contract.
- Document the steps you take and processes you follow to ensure that the plan's service contracts are reasonable, necessary and for no more than compensation.

What To Do If A Service Provider Does Not Provide A Disclosure?

As stated above, if a covered service provider fails to provide the required disclosures, you risk having engaged in a breach of fiduciary duty by allowing a prohibited transaction to occur. However, it is possible for you to protect yourself from a breach of duty if you take action following your discovery of the service provider's failure to disclose. Under DOL regulations, no breach will occur if:

1. You did not know the service provider failed or would fail to make the required disclosures and reasonably believed the service provider disclosed the required information.
2. Upon discovering the service provider failed to disclose the required information, you request in writing that the service provider furnish the information.
3. If the service provider fails to comply with the written request within 90 days, you notify the DOL of the service provider's failure. The notice is required to be provided no later than 30 days following the earlier of the service provider's refusal to provide the required disclosures or 90 days after the written request.

You must also determine whether to terminate or continue the service provider's contract by evaluating the nature of the failure, the availability, qualifications and cost of replacement service providers and the service provider's response to being notified of the failure. If the service provider fails to cure the breach, you will need to terminate the arrangement.

Summary

As a responsible plan fiduciary, you have some work to do as you begin to receive the 408(b)(2) disclosures, to use the disclosures to protect the plan from paying more than reasonable compensation to service providers and to protect yourself from potentially breaching your fiduciary duty. Butzel Long's Employee Benefits Group is ready to assist you during this process. We can work with you as part of your due diligence process, have checklists and can provide other guidance to help. If you have questions regarding the ERISA 408(b)(2) requirements, other aspects of ERISA fiduciary compliance or other employee benefits matters, please contact the author of this Alert, a member of the Butzel Long Employee Benefits Practice Group, or your regular Butzel Long attorney.

Jordan Schreier

734 213 3616

schreier@butzel.com

Butzel Long Employee Benefits Practice Group

Alexander B. Bragdon

Phone: 248 258 7856

Email: bragdon@butzel.com

Robert G. Buydens

Phone: 313 225 7013

email: buydens@butzel.com

Roberta Granadier

Phone: 248 593 3020

Email: granadier@butzel.com

Mark W. Jane

Phone: 734 213 3434

Email: jane@butzel.com

Lynn F. McGuire

Phone: 734 213 3261

Email: m McGuire@butzel.com

Jordan Schreier

Phone: 734 213 3616

Email: schreier@butzel.com

Thomas L. Shaevsky

Phone: 248 258 7858

Email: shaevsky@butzel.com

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