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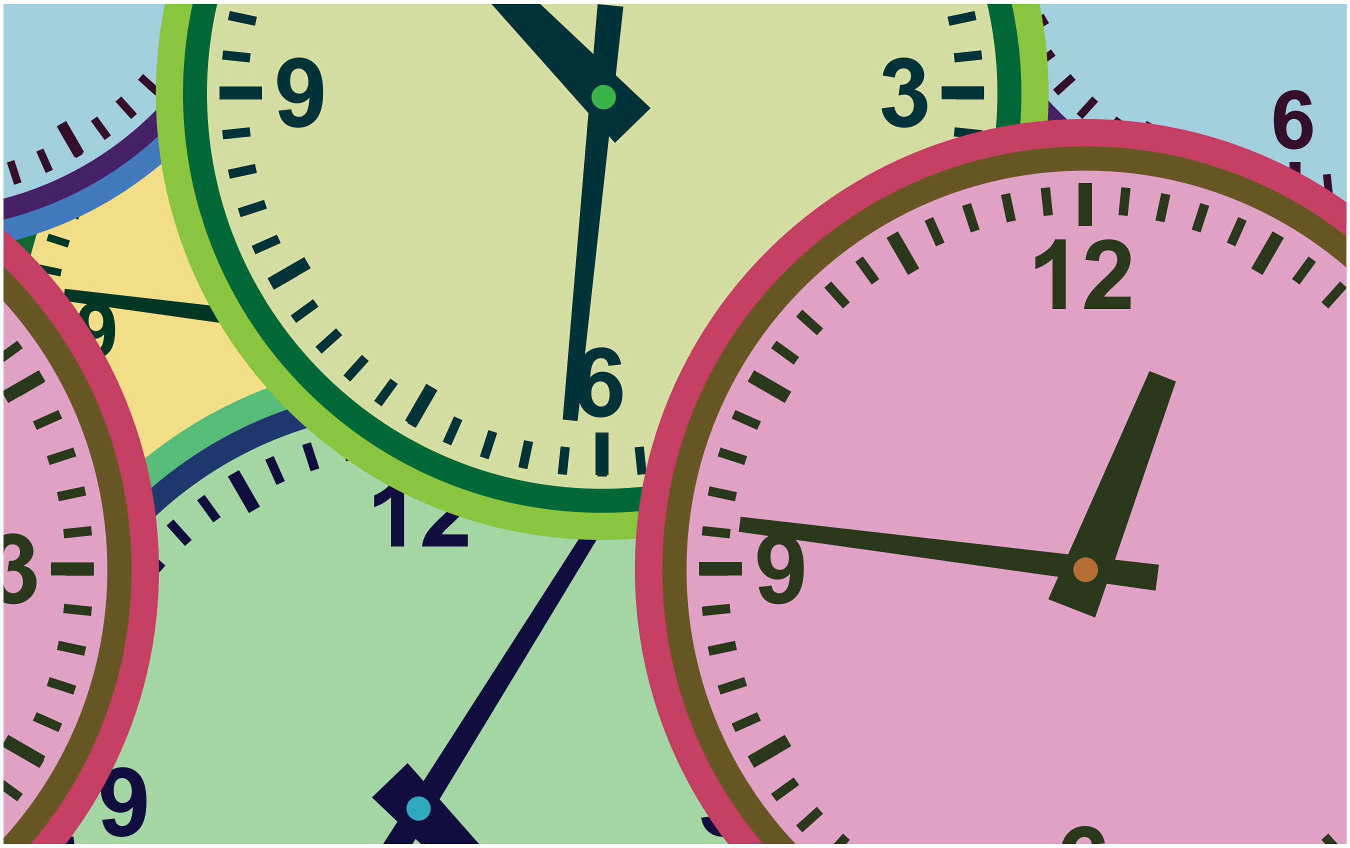

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The Clock is Ticking: 408(b)(2), *Tussey v. ABB* and Time

The DOL and plaintiff firms will be evaluating the 2012 audit results for trends and vulnerabilities among RPFs and CSPs for targeting DOL audits and plaintiff litigation activity in 2014.

BY DAVID J. WITZ

The anxiety over distributing 408(b)(2) disclosures by July 1, 2012 now seems like a distant memory. Covered Service Providers (CSPs) of all sorts prepared disclosures that either identified expenses for services not previously disclosed or they prepared disclosures that referenced documents previously distributed.

What was intended to provide a Responsible Plan Fiduciary (RPF) with "comprehensive information about the services that are provided to employee benefit plans, and the cost of those services"[1] may have met the letter of the law, but has it helped an RPF "satisfy their fiduciary obligations under ERISA section 404(a)(1) to act prudently and solely in the interest of the plan's participants and beneficiaries?"[2] At this point,

1 77 FR 5632 (Feb. 3, 2012).
2 Id.

"Fees may be reasonable but if the disclosures are not complete, the exemption is lost."

there seems to be more consternation on the part of CSPs than RPFs who are concerned that their disclosures may be found to fall short. For most RPFs, 408(b)(2) is old news with little fanfare, but for the CSP community, concerns remain. Will our disclosures carry the day if they are tested in court?

IT'S AUDIT SEASON

This CSP anxiety is magnified in anticipation of the 2013 audit season and the potential obligations imposed by Judge Laughrey's decision in *Tussey v. ABB.* Regarding the audit season, there is a debate over the legal specificity imposed on auditors regarding their role and responsibility to report 408(b)(2) violations. According to the AICPA *Audit and Account Guide for Employee Benefits Plans:*

> "ERISA requires that *all transactions* with parties in interest (excluding any transactions exempted from prohibited transaction rules) be disclosed in the supplementary schedule *without regard to their materiality.* Only those party in interest transactions that are considered prohibited by ERISA, *regardless of materiality,* should be included on the Schedule G, Part III- Nonexempt Transactions."3 (Emphasis added)

Based on the *Audit Guide,* materiality is a non-issue when it comes to a prohibited transaction regardless of amount. One significant reason is because a prohibited transaction gives rise to a plan receivable.[4] Although the audit community continues their debate with the Department of Labor's Chief Accountant and among themselves regarding their 408(b)(2) reporting role and responsibility, some auditors have decided to take a deeper dive — at an additional cost to the RPF — to determine if disclosures are complete and fees are reasonable.

However, other auditors are requesting evidence that a documented process exists. This may become the impetus for the RPF to retain an outside consultant to assist with the assessment. And finally, another position held by some auditors is that evidence that disclosures exist with a verbal confirmation by the RPF that they are complete and fees are reasonable is sufficient, even if the auditor knows that the RPF lacks the knowledge, skill and expertise to draw a reliable conclusion.

Regardless of which approach an auditor takes, the DOL and plaintiff firms will be evaluating the 2012 audit results for trends and vulnerabilities among RPFs and CSPs for targeting DOL audits and plaintiff litigation activity in 2014. The clock is ticking!

TUSSEY V. ABB SETTING NEW STANDARDS

Last year we saw a landmark trial order issued on March 31, 2012, in *Tussey v. ABB.* The implications of this decision, the second case subject to a bench trial, affects not only RPFs in the 8th Circuit,[5] it also affects the risk mitigation strategies for any plan sponsor nationwide. At this point, to ignore Judge Laughrey's conclusions is a risky proposition.

There are three distinct conclusions that can be drawn from the decision that impact future fee disclosure for RPFs that utilize revenue sharing to pay all or a portion of their CSP's fees:

1. While fees on the whole may be reasonable, a RPF must determine if fees for each component are reasonable.[6]
2. If revenue sharing is captured to subsidize fees for services rendered, it must be evaluated in dollars even though 408(b)(2) and the Schedule C accept a formula.[7]

3 AICPA Audit and Accounting Guide ¶ 11.19, page 224 (Jan. 1, 2011).
4 AICPA Audit and Accounting Guide ¶ 5.117, page 146 (Jan. 1, 2011).
5 The decision is currently on appeal to the 8th U.S. Circuit Court of Appeals, which will issue a decision that is binding on all employers in the states covered by the 8th Circuit including Missouri, Arkansas, Nebraska, Iowa, Minnesota, North Dakota and South Dakota.
6 Judge Laughrey emphasized that focusing exclusively on the total cost as a percent to the exclusion of the cost for each service does not provide the fiduciary with the information needed to make a prudent decision, "the expense ratio does not show how much revenue is flowing from the investment company to the recordkeeper." Doc. 623 (W.D. Mo.) – Trial Order, page 19 (Mar. 31, 2012).
7 In several instances Judge Laughrey references a lack of dollars to assist with the evaluation of reasonable fees. For example, "First, the expense ratio does not show how much revenue is flowing from the investment company to the recordkeeper." Page 19; Second, because it failed to calculate how many dollars would be or had been generated by revenue sharing for Fidelity Trust, ABB could not analyze how revenue sharing would benefit the Plan… Doc. 623 (W.D. Mo.) – Trial Order, page 30 (Mar.31, 2012).

> ‘Process’ is a key to defending a claim of fee reasonableness, and documentation is the elixir which proves that process exists.”

3. If revenue sharing is captured, it must be compared.[8]

Comparing revenue sharing by fund against different platforms is not an easy task. With the exception of PlanTools, there is no commercially available computer application that permits an RPF to compare the revenue sharing payments by each investment alternative against many different platforms. In one recent analysis conducted by PlanTools on a plan with $137 million in plan assets, the revenue sharing ranged from $250,000 to $610,000 for the same exact funds when comparing 22 different platforms. This difference could be attributable to any of the following reasons:

1. Some platforms may be better at negotiating revenue sharing than others.
2. Contracts may have been negotiated at a time when a particular platform was aggressively pursuing new business.
3. Some of the revenue sharing may have been negotiated as an annual flat dollar payment in order to circumvent reporting the amount as indirect or as non-monetary compensation.[9]
4. There may be a hold-back of a part of the revenue sharing by the platform.

It is our position that is it impossible to determine if the amount a plan is receiving is reasonable without conducting a comparison between platforms. At the same time, just because one platform pays out more revenue sharing on a particular fund versus another platform, that does not mean the services rendered are any better or that their base fees paid with revenue sharing are any lower than the competition’s.

In spite of the need to provide complete fee transparency, several platform providers continue to vehemently protect this information from becoming more broadly available so that a prudent assessment of reasonableness can be conducted. Granted, much of this information is readily available via Form 5500 filings and their corresponding attachments for plans with 100 or more participants, but that fact does not stop some platform providers from taking steps to suppress the ability of plan sponsors to compare and contrast revenue sharing.

If your platform provider is not willing to make this information publicly available or if they take steps to suppress the public’s broad access to this information, this should raise a red flag that they might be hiding something. Should this be the case, consideration should be given to moving to a platform that is cooperative in providing a full disclosure of all indirect fees; otherwise, the RPF could become liable for a prohibited transaction initiated by the CSP by the RPF failing to take steps to remedy the situation. The clock is ticking!

ESTE PARATUS (BE PREPARED)

Has anyone ever called you “a Boy Scout”? If so, it was probably a compliment. A Boy Scout conjures an image of a selfless individual always prepared to help. The Scout motto is *este paratus:* Latin for “be prepared.” With regard to 408(b)(2) compliance, it is a motto every RPF would be prudent to embrace, since relief from a prohibited transaction is conditioned on meeting the disclosure requirements.

To be prepared to defend a conclusion that disclosures are complete, an RPF should follow the Department of Labor’s recommendation outlined in the preamble to the final regulation:

> 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*

8 Judge Laughrey repeats the need to compare fees and since fees were primarily paid from revenue sharing it is necessary to compare the revenue sharing from different funds or even different platforms. For example, “Second, it does not show what the competitive market is for recordkeeping fees for comparable funds.” Doc. 623 (W.D. Mo.) – Trial Order, page 19 (Mar. 31, 2012).

9 For purposes of completing a Schedule A supplement to the annual 5500 form, an RPF is permitted to exclude non-monetary compensation of insubstantial value. Insubstantial means the gift, meal or gratuity is valued at less than $50 and the aggregate value from one source in a calendar year is less than $100. In addition, it is possible to allocate the value of non-monetary compensation on a pro-rata basis among ERISA and non-ERISA assets as well as among all retirement plans providing a basis to exclude such compensation from being reported even though the gross amount paid to exceeds the entire fee paid by the plan sponsor. FAQs about the 2009 Form 5500 Schedule C.,” #34 (July 2008); However, according to the Department of Labor, the value of a gift is not reportable compensation for purposes of the Schedule C if neither the amount of the gift nor the eligibility to receive the gift is based, in whole or in part, on the recipient’s position with one or more ERISA plans, or the amount or value of services provided to or business conducted with one or more ERISA plans. Supplemental FAQs about the 2009 Form 5500 Schedule C,” #3 (Oct. 2010); Finally, compensation as defined under 408(b)(2) is anything of monetary value (for example, money, gifts, awards, and trips), but does not include non monetary compensation valued at $250 or less, in the aggregate, during the term of the contract or arrangement. 29 C.F.R. § 2550.408b-2(c)(1)(viii)(B) and see 77 FR 5646 (Feb. 3, 2012).

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.[10] (Emphasis added)

In short, an RPF that is prepared to defend its claim to the prohibited transaction exemption will have taken the necessary steps to compare the disclosures received to the regulation to form a reasonable belief disclosures are complete. To accomplish this task, a RPF can either:

- conduct a comparison of the disclosures to the regulations without assistance, or
- retain the services of a professional to conduct the analysis on their behalf.

Due to the complexity of conducting this assessment, it is unlikely that many RPFs have the knowledge, skill and expertise to prepare this analysis without professional assistance. However, the RPF can take steps that can reduce the cost of this analysis by taking the following steps in advance of the engagement:

1. Assemble all 408(b)(2) disclosures, including all contracts, service agreements and documents referenced in each 408(b)(2) disclosures.
2. Send a letter to each CSP requesting any missing information and written confirmation that everything the CSP was obligated to provide has been provided in a complete format.
3. Inform the CSP in writing that you have retained a professional to conduct a 408(b)(2) compliance assessment and that they have your permission to release any information to your consultant that is requested with a copy provided to you directly.

Sending a letter to each CSP requesting information and identifying your consultant is an important step in the assessment process. The purpose of the letter is to help you:

1. Establish a documented process to confirm the disclosures are complete.
2. Request information needed or confirmation of facts from each service provider.
3. Reduce liability for the RPF by providing a documented trail of prudent activity.
4. Obtain a response from the service provider that can be relied upon in good faith.

If a CSP fails to respond to the RPF's request for information within 90 days, the RPF has 30 days to report the CSP to the DOL. Failure to report a CSP, even if the CSP provides the required information during the 30 days following the 90-day grace period, causes the RPF to become jointly liable for the prohibited transaction. Unfortunately, this requirement leaves a RPF no choice but to report their CSP to the DOL to avoid liability for a prohibited transaction. The clock is ticking!

CONCLUSION

It is important to emphasize that fees may be reasonable but if the disclosures are not complete, the exemption is lost. Once a determination is made that all disclosures from each CSP are complete, a determination must be made whether fees are reasonable for services rendered. This requires a two-step process:

1. Compare fees, including revenue sharing.
2. Document the reasons you believe fees are reasonable.

To conduct a proper comparison, the RPF must either engage in a comparative analysis that would result in a formal request for proposal (RFP) process and/or a fee benchmarking analysis. Of the two options, benchmarking is certainly the most efficient, unbiased, conflict-free and cost-effective approach, assuming the data is from an independent source.

Preparation of the benchmarking report can be conducted by any incumbent service provider as long as the incumbent service provider does not have discretionary authority and control to:

- retain itself,
- determine its fee, or
- declare that its fees are reasonable without independent confirmation by another unaffiliated fiduciary.

Finally, with the benchmarking report in hand, the RPF must document why it believes fees are reasonable. The documentation does not have to be meticulously detailed, but it must be sufficient to establish that the RPF believes fees are reasonable for services rendered. Keep in mind that reasonableness is not defined as the lowest or even average fees. Instead, the RPF has the right to make a subjective decision based on objective facts.

Remember, "process" is a key to defending a claim of fee reasonableness, and documentation is the elixir which proves that process exists. By taking the appropriate steps to evaluate and monitor fee reasonableness for services rendered according to a documented process on an annual basis, an RPF can rest assured that time is not its enemy! PC

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10 77 FR 5648 (Feb 3, 2012).