Disclosure Obligations Post 408(b)(2)

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Background

- The trend: full transparency, i.e., full disclosure of all costs, compensation and conflicts of interest by plan service providers.
- The drivers: class action fee litigation; Congressional activity; and DOL Proposed 408(b)(2)
- Status of 408(b)(2) is uncertain
  - OMB – too expensive
  - Miller – not onerous enough and will introduce new legislation
  - DOL – to reconsider

Background

- ERISA 406(a)(1)(C) prohibits the "furnishing of goods, services or facilities between a plan and a party in interest."
- ERISA 408(b)(2) provides an exemption for "contracting or making reasonable arrangements with a party in interest for… services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid."
- Traditionally, the burden has been on the primary plan fiduciary to investigate and understand the arrangement to determine its reasonableness

Proposed 408(b)(2)

- In December 2007, the DOL published its proposed 408(b)(2) regulation that mandates a written agreement with and disclosure of compensation and conflicts of interest by plan service providers, thus shifting the burden to the service providers to provide plan fiduciaries with the information required to determine the arrangement’s reasonableness
  - Delivery must be made sufficiently in advance to give the plan fiduciary time to review before entering into the transaction
  - Delivery is required to be made to the responsible plan fiduciary

Affected Service Providers

- 408(b)(2) proposal affects all service providers who:
  - are fiduciaries under ERISA or Investment Advisers Act of 1940;
  - provide banking, consulting, custodial, insurance, investment advisory, investment management, recordkeeping, securities, other investment brokerage, or TPA services; or
  - receive indirect compensation and provide accounting, actuarial, appraisal, auditing, legal, or valuation services.

General Disclosure Obligations

- ERISA 406(a)(1)(C) and 408(b)(2), when read together, prohibit unreasonable arrangements between plans and service providers
- Fiduciaries have an obligation to understand and evaluate plan costs and service provider compensation
- DOL has expressed its position relative to disclosure in: fiduciary adviser regulations and Schedule C disclosure requirements
- Best practices suggest full transparency and exhaustive disclosures

Disclosures – Services & Compensation

- All services to be provided to the plan
- Any and all direct and indirect compensation to be received by the service provider and its affiliates
  - monetary (fixed amount, pursuant to a formula based on plan assets, a per participant charge or all of the above); and
  - non-monetary items (e.g., gifts, awards and trips)
- The method for calculating and repaying any prepaid compensation if the contract terminates
- The manner of receipt of the compensation

Disclosures – Fiduciary Status

- Whether service provider or affiliate will be providing services to the plan as an ERISA or Advisers Act fiduciary
  - Status should be broken down by activity
  - Broker-dealer issues
  - “Consulting”

Disclosures – Financial or Other Interest

- Must disclose whether service provider or affiliate will have any interest in the any transaction entered into by the plan in connection with covered services
  - If service provider receives payments or reimbursements of expenses from other service providers, this must be disclosed
  - If so, must provide description of the transaction and participation therein

Disclosures – Other Relationships

- Must disclose any material (financial, referral or other) relationships with money managers, brokers, or other service providers to the plan
  - Finders' fees / solicitors' payments
  - Cross-referral arrangements

Disclosures – Ability to Affect Comp.

- Must disclose ability to affect compensation without prior approval of independent plan fiduciary
  - Incentive, performance-based, float or other contingent compensation

Disclosures – Policies to Address Conflicts

- Service provider must disclose whether it or an affiliate has any policies or procedures that address or prevent actual or potential conflicts of interest
  - If so, they must be explained

Material Changes & Reporting

- Contract must require the service provider to disclose any material change (to the information required to be disclosed) to the responsible plan fiduciary within 30 days of knowledge
- Proposal requires service providers to disclose “all information related to the contract and any compensation received thereunder” if it is requested to comply with ERISA’s reporting and disclosure requirements

Action Items – Plan Sponsors

- Notify service providers of their obligation to report
- Establish procedures for information gathering and reporting
- Identify all forms of compensation and verify procedures to offset indirect payments if applicable
  - Investigate affiliates of the service provider
- Investigate potential conflicts of interest and procedures designed to avoid same
- Document the basis for determination of reasonableness
- Obtain and retain compliant agreements from all service providers
  - Contract must affirmatively require service provider to make disclosures

Action Items – Service Providers

- Create compliant disclosure documents and procedures for delivery thereof
  - Review corporate ethics and conflicts of interest policies
  - Develop procedures for reporting of material changes to disclosures within allotted time (30 days)
- Create compliant ERISA-specific written agreements
  - obtain acknowledgement that: (i) required disclosures were received sufficiently in advance; (ii) by the responsible plan fiduciary; and (iii) were determined to be reasonable and necessary for the establishment/operation of the plan
  - Establish procedure for changing compensation (e.g., Aetna AO 97-16A)

Questions?

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