408(b)(2) Enforcement Has Arrived

The DOL's expectations during an investigation

When a plan sponsor recently received a notice announcing a Department of Labor (DOL) investigation of its plan, it was clear, based on the request for documents, that the investigator planned to look at 408(b)(2) compliance.

As background, the 408(b)(2) regulation requires that service providers make disclosures about services, compensation and fiduciary status. That's the starting point. The law then requires that the fiduciaries evaluate those disclosures and determine whether the compensation is reasonable in light of the services. Usually, that requires benchmarking against industry averages for similar providers and comparable services.

This article is not about 408(b)(2) disclosures, however, but about the DOL's expectations during an investigation. Among other things, the investigator will look for:

- Copies of all required fee disclosures from service providers;
- All written agreements and contracts relating to services rendered to the plan by all service providers;
- Minutes of any board of directors' meetings in which the plan was discussed, as well as the minutes of any plan trust or plan committee meetings; and
- Documents supporting the compensation disclosures on Schedules A and C to the Form 5500—e.g., documents that "include all indirect compensation reported on Schedule C." As the request explains, that means all brokerage commissions, sub-transfer agency fees, shareholder servicing fees, account maintenance fees, 12b-1 distribution fees, etc.

Some Thoughts

Pity the committee that doesn't have that information. While there may be exceptions, it would be difficult for a committee to evaluate compensation of its service providers if it hadn't calculated the amount of that payment, including indirect compensation such as 12b-1 fees and sub-transfer agency fees. For those fees, a committee would need data about how the amounts were calculated and who was paid. In other words, a committee should already have that material in its due diligence file. Also, a committee should have some industry information about the compensation of similarly situated service providers. At the least, plans ordinarily have a recordkeeper and an adviser. The due diligence file should contain benchmark information for both types of providers.

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Also, the committee minutes should include a discussion about the review of the disclosures and the benchmarking process. Committee minutes can be documentation of a job well done or, if they say nothing, can indicate a failure to fulfill those fiduciary obligations.

But what if a committee hasn't reviewed the 408(b)(2) disclosures, hasn't obtained benchmarking information and hasn't evaluated the compensation of its service providers? Obviously, that's a problem. I believe that the best course of action for that committee would be for it to take those steps right now. If a committee goes through that process and decides that the costs are—and were—reasonable, then, while there may have been a fiduciary failure by not having done it earlier, at least the members will know there had been no damages—the plan and participants hadn't been hurt by making excessive payments.

On the other hand, if the committee finds that the compensation of a provider was excessive, it can stop the bleeding, so to speak—and limit liability—by immediately negotiating reasonable compensation with that provider, and perhaps recouping excessive compensation paid in the past. If a provider won't negotiate, the answer is fairly obvious: Fire the provider and hire a new one. It doesn't make any sense for fiduciaries to keep a provider that is hurting the employees by charging excessive fees. And to do so would be dangerous to the fiduciaries, since they are the ones at risk.

This is not rocket science. It just requires that a committee pay attention.

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