The importance of the 408(b)(2) fee disclosure

Plan fiduciaries are required to act prudently and solely in the interest of the plan's participants and beneficiaries when selecting and monitoring service providers and plan investments. As part of these duties, fiduciaries must ensure that arrangements with plan service providers are "reasonable" and that only "reasonable compensation" is paid for such services.

The new sponsor-level fee disclosure regulations (ERISA Section 408(b)(2)) from the Department of Labor (DOL) require service providers to send plan fiduciaries certain disclosures so the fiduciaries have the necessary information to determine whether their arrangements with the service providers are reasonable.

The new regulations are beneficial. Plan fiduciaries are now able to see the fees and expenses being charged to the plan and compare them with fees charged by other service providers. The following case demonstrates the importance of understanding the fees being charged to a plan.

Fiduciary breach

In *Tussey vs. ABB, Inc.* (Ronald Tussey, et. al., v. ABB, Inc., et. al., WD-MO 3/31/2012), the court awarded over $35 million in damages because of a breach of ERISA fiduciary duties by an employer and its investment advisor and recordkeeper. Although the events and the decision in this case occurred before the effective date of the sponsor-level fee disclosure regulations (July 1, 2012), this case underscores the significance of those regulations.

The fiduciary had been provided with certain key information regarding higher than usual costs being charged to the plan. However, the fiduciary didn't act on the information, thus failing to fulfill its responsibility to act prudently in the interest of the plan's participants and beneficiaries.

Case background

ABB, Inc. has two 401(k) plans that permit participants to direct their contributions among investment options preselected by ABB. The plan includes mutual funds offered by **F** Investments. Defendant **F** Research is the investment advisor to **F** Investments' mutual funds offered by the plans. **F** Research invests the balances of bank accounts that hold plan contributions in overnight securities. **F** Trust, an affiliate, serves as the recordkeeper.

Originally, **F** Trust was paid a per-participant, hard-dollar fee. Over time, the arrangement changed and fees were paid primarily by payments through revenue-sharing agreements. Under the revenue-sharing arrangement, **F** Trust's fee grew as the assets of the plan grew, even if no additional services were provided to the plan. If the plan's assets declined, the amount paid for services could decline; in which case, **F** Trust asked for hard dollars to make up the difference. **F** Trust also had the right to amend its compensation agreement for plan services.

The plan's investment policy statement stated that revenue sharing should be used to offset recordkeeping costs and required ABB to leverage the plan's size and assets (over $1 billion) to reduce recordkeeping costs when revenue sharing exceeded the market value for **F** Trust's services. ABB did not comply.

F Trust also provided ABB with benefit outsourcing services, including payroll services; recordkeeping services for its health insurance, welfare plans, and a defined benefit plan; and additional retirement benefits for its highly compensated employees. **F** Trust lost money on these services, but it made a substantial profit as the 401(k) recordkeeper. A consulting firm advised ABB that it was overpaying for 401(k) plan recordkeeping fees, and it appeared the 401(k) plan was actually subsidizing the other non-401(k) plan services **F** Trust was providing. The plaintiffs contended that a breach of fiduciary duty occurred when ABB received this information and failed to take action.

Court findings

The federal district court agreed. It found that ABB and **F** Trust had breached their fiduciary duties. ABB's breaches included:

- Failing to monitor recordkeeping costs and failing to negotiate rebates for the plan,
- Selecting more expensive share classes for the investment platform when less expensive share classes were available, and
- Paying **F** Trust an amount that exceeded market costs for plan services in order to subsidize the corporate services **F** provided to ABB.

F Trust's breaches included:

- Failing to distribute float income solely for the interest of the plan, and
- Transferring float income to the plan's investment options instead of the plan.

Conclusion

The Tussey case is important because it reinforces the requirement that plan fiduciaries must be prudent when hiring and monitoring the plan's service providers. The sponsor-level fee disclosure requirements will make it easier for responsible plan fiduciaries to understand the types of fees the plan is paying its service providers and to avoid the errors made by the trustees of the ABB plans.

This case also highlights the importance of a thorough review of asset-based fee arrangements to determine if they are prudent, especially when plan assets have increased significantly.