

4Q 2008



Update on Regulation 408(b)(2)

In 2007-2008, the Department of Labor proposed regulation under ERISA Section 408(b)(2) that explains the prohibited transaction exemption in ERISA which required contracts and arrangements between Plans and Service Providers to be “reasonable.” The regulation was finalized by the Department of Labor and sent to the Federal Office of Management and Budget in September, as a final step before issuance. As of early January 2009, the final regulation has not been issued despite official guidance of a late-2008 release. With the change in the administration and broader economic concerns, the regulation may or may not be released in its present form; it may go back to the legislative body or be incorporated as part of a broader set of regulations.

As proposed, section 408(b)(2) would provide relief from ERISA’s prohibited transaction rules only if the contract and arrangement between the plan and the service provider is reasonable, if the services are necessary for the establishment or operation of the plan, and if no more than reasonable compensation is paid for the services. However, to fully comply with their fiduciary duty, plan sponsors will need to understand, review and monitor the aforementioned arrangements in order to assess reasonableness of the fees for the services provided. The implications of the proposal may have a broad impact on the way service providers, such as registered investment advisors, broker-dealers, record keepers and third-party administrators disclose their compensation and conflicts of interest. While many of these parties have come a long way towards full disclosure, others may need to provide significant amendments and provide more transparency in order to comply with the proposed regulation.

In conclusion, despite uncertainty associated with the proposed regulation, plan sponsors have an existing fiduciary duty to obtain, understand and evaluate the arrangement between the plan and service providers to ensure that the arrangements are reasonable. As plan sponsors become more educated and comply with their obligations, the need for transparency of services and disclosure of potential conflicts of interest will remain as mandated by the DOL, ERISA, and/or industry best practice.



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