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408(b)(2) Disclosures

Nonmonetary compensation may count!

The July 1 effective date for the new 408(b)(2) regulation is fast approaching. While the industry is in the midst of preparing disclosures of the direct and indirect compensation earned by covered service providers to covered retirement plans, keep in mind that the new regulation deals with not only dollars and basis points, but nonmonetary compensation, too.

The new regulation's definition of "compensation" means anything of monetary value, including nonmonetary items, such as gifts, awards and trips, if the total value of the nonmonetary items received by a covered service provider exceeds $250 during the term of the covered contract or arrangement.

Deciphering whether the $250 threshold has been exceeded can be tricky. In the preamble to the final regulation, the Department of Labor (DOL) explicitly rejected suggestions that the amount should be measured over a calendar-year or plan-year basis. Instead, "the term of the contract or arrangement" was adopted as the measuring-period basis.

Contract or service arrangements with indefinite terms and those with terms that extend over several years are likely to present special challenges for service providers seeking to take advantage of the exclusion. Even if the provider can be confident that any nonmonetary compensation it receives is less than $250 per plan annually, the longer term of the arrangement can be an obstacle in proving that the $250 limit will not be reached over that time.

The preamble also suggests that covered service providers look to the guidance and methodologies concerning nonmonetary compensation that have been approved for purposes of the Form 5500 Annual Report, including the Schedule C guidance available on the DOL website. The Schedule C guidance addresses nonmonetary compensation.

On the helpful side of the equation, DOL guidance makes clear that most promotional items, such as coffee mugs, calendars, greeting cards, plaques and trophies, do not need to be counted.

The cost of meals, hotels, transportation, gifts of a substantial nature—such as expensive pens and golf clubs—and tickets to an entertainment event are a different story. The value of those sorts of items needs to be counted if the items were provided based on a recipient's ERISA plan business—be it involving a single plan or a block of plans. When more than one plan is involved, the guidance suggests that the value be allocated among the ERISA plans *pro rata* or on some other reasonable basis.

The DOL also provides specific guidance on conference attendance. Waivers or discounts of conference registration fees count as reportable indirect compensation. Conference overhead expenses, such as for a continental breakfast and other refreshments, are not reportable indirect compensation if they are normally included in the conference registration fee. By implication, dinners or other entertainment events that are invitation-only—i.e., not available to all registered attendees—count as separately reportable compensation.

The Schedule C instructions and the FAQ guidance also warn plan fiduciaries that gifts and gratuities of any amount paid to or received by them "may violate ERISA and give rise to civil liabilities and criminal penalties." This admonition is tempered somewhat by DOL enforcement manual guidelines; these suggest that investigators and auditors treat the receipt by a fiduciary of less than $250 annually of nonmonetary compensation from any one source as insubstantial, and not as an apparent violation of section 406(b)(3), ERISA's anti-kickback provision.

Unfortunately, while they share a common $250 measuring threshold, the enforcement manual guideline and the 408(b)(2) nonmonetary compensation exclusion are not otherwise symmetrical. The enforcement manual measures nonmonetary compensation on an annual basis while the 408(b)(2) regulation measures with the term of the contract or arrangement. Moreover, 408(b)(2) counts reportable nonmonetary compensation received from all sources against the limit. By contrast, the enforcement manual measures nonmonetary compensation received from any one source.

Demonstrating compliance with the nonmonetary compensation rules may require substantial effort. As part of their 408(b)(2) preparedness, service providers may want to revise their entertainment and gift policies to include items received at conferences and to develop reasonable methodologies for allocating the value of those items among ERISA plan clients.

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