

# Participant and sponsor fee disclosure regulations



## What they mean for you

In 2012, the Department of Labor (DOL) finalized its Sponsor fee disclosure regulations impacting

- the disclosure of fees from plan sponsor to participant; and
- the disclosure of fees from service provider to plan sponsor.

For calendar year plan years, effective August 30, 2012, participant-directed individual account defined contribution plans must provide certain investment and fee information to participants prior to their first right to diversify their investments, and annually thereafter. Effective 45 days after the end of the quarter in which the initial disclosures are required to be furnished to participants (i.e. November 14, 2012), certain fee information must be provided quarterly.

Effective July 1, 2012, covered service providers must disclose to plan sponsors the terms of the arrangements in order to give fiduciaries adequate information to determine whether or not the arrangement is.” This information must be provided in writing, and it must describe both the services the provider performs, as well as the compensation received for such services.

*As an advisor to sponsors of qualified plans, you will need to help navigate your clients through the complexity of these fee disclosure regulations while demonstrating the value and importance of the services you offer to your clients.*

## Sponsor Fee Disclosure Under ERISA §408(b)(2)

Are advisors considered “covered service providers” under sponsor fee disclosure?

It depends upon the structure of the relationship and the services that are being provided to retirement plans and their sponsors. A covered service provider is one that enters into a contract or arrangement with the covered plan and reasonably expects to receive \$1,000 or more in compensation, direct or indirect, for providing certain types of services to the plan. A covered service provider performs:

1. Services as a fiduciary or registered investment adviser, including:
  - a. Anyone who performs services as a fiduciary to the plan under ERISA §3(21);
  - b. Anyone who performs services as a fiduciary to an investment contract, product or entity that holds plan assets; and
  - c. Anyone who performs services as an advisor registered under the advisor’s act or under applicable state law.
2. Certain recordkeeping or brokerage services; and
3. Other services for indirect compensation
  - a. Accounting, auditing, actuarial, appraisal, banking, consulting (i.e. consulting related to the development or implementation of investment policies or objectives or the selection or monitoring of service providers or plan investments), custodial, insurance, investment

*advisory (for plan or participant), legal, recordkeeping, securities or other investment brokerage, third party administration or valuation services provided to the plan.*

If the advisor is paid directly by the sponsor and not through plan assets, then the fee disclosure portion of these new regulations would not apply to them. If an advisor is not acting in any fiduciary capacity to the plan, then that advisor would need to consider whether he or she would qualify as a covered service provider under the “other services for indirect compensation” definition as providing consulting or investment advisory services. However, if the advisor reasonably expects to receive only direct compensation under the other services for indirect compensation definition, then he or she would not be considered a covered service provider.

This information is being provided as a summary of the requirements. However, an advisor must make his or her own determination of whether the advisor is considered a covered service provider. An advisor should also check with his or her broker/dealer to help determine if the advisor qualifies as a covered service provider.

#### **How does the DOL define direct vs. indirect compensation?**

The regulations define direct compensation to mean any compensation received directly from the plan. Indirect compensation is defined as any compensation received from any source other than the plan, the sponsor, the covered service provider, an affiliate or a subcontractor. For example, revenue sharing payments paid to the advisor would be considered a form of indirect compensation.

#### **What if an advisor does perform fiduciary services to the plan? Are there additional requirements?**

If an advisor (or affiliate or subcontractor of the advisor) performs services as a fiduciary (or as an advisor registered under the advisors act or state law) to the plan, the advisor would be required to disclose, in writing, to the sponsor that they are acting in a fiduciary manner to the plan.

#### **If an Advisor determines that he or she is a covered service provider, what does that advisor need to do to comply with these regulations?**

For existing clients, prior to July 1, 2012, the advisor must provide to them, in writing, with the following information:

1. Description of the advisor services provided to the plan
2. Statement of the advisor’s (or affiliate’s or subcontractor’s) fiduciary status, if applicable
3. Description of the advisor’s compensation, both direct and indirect, as well as compensation paid to an affiliate or subcontractor of the advisor
4. Description of any compensation that will be paid among the covered service provider, affiliate, or subcontractor in connection with the services provided, if the compensation is set on a transaction basis (e.g. commissions, soft dollars, finder’s fees or other similar incentive compensation based upon business placed or retained) or is charged directly against the plan’s investment and reflected in the net value of the investment (e.g. Rule 12b-1 fees)
5. Description of any compensation for termination of the contract with the plan,
6. A description of the manner in which such compensation will be received (e.g. will the advisor bill the plan or will it be deducted directly from plan or investments)
7. If the advisor is a covered service provider acting in a fiduciary manner to the investment in a contract, product or entity that holds plan assets, additional investment related information would be required

For new clients beginning on or after July 1, 2012, advisors must generally provide this information to the plan reasonably in advance of the date the contract is entered into, extended or renewed.

#### **What if any information in the required disclosure changes?**

If information in the required disclosures changes, the advisor will need to send to sponsors, at least annually for investment information or within 60 days for other changes, the change information so they can determine if such

change is “reasonable” and appropriate to satisfy sponsor’s fiduciary obligation. Examples of such changes would include changes in the advisor’s compensation, paid either directly or indirectly from the plan, and changes to the services provided by the advisor, etc.

### **What if the advisor fails to meet his or her required disclosure obligation?**

If an advisor fails to meet his or her disclosure obligation, this failure to comply could be deemed a prohibited transaction subject to a 15% excise tax. In addition, the method of correction could include returning any compensation that was received for services that were not properly disclosed.

## **Participant Fee Disclosure under ERISA §404(a)(5)**

### **Who is responsible for satisfying the participant fee disclosure requirements?**

Plan sponsors are required to provide certain investment and fee information to participants prior to their right to diversify their investments, and annually thereafter. In addition, certain fee information must be disclosed on a quarterly basis.

### **What type of information will be included on the annual disclosure?**

The annual disclosure will contain detailed investment and fee information including:

1. General plan information including how a participant can make investment selections, description of any plan-related limitations on such instructions, description of any proxy voting rights, etc.
2. Investment related information including rates of return, investment benchmark, fees/expenses associated with such investment, etc.
3. Description of plan related administrative expenses (e.g. per participant fees, asset-based fees)
4. Description of individual-related expenses (e.g. loan fees, withdrawal fees, QDRO fees)

Attached to this is a sample annual disclosure document that First Mercantile will be sending to participants.

## **What type of fee information will be included on the quarterly statement?**

Any plan and individual related fees deducted from participant accounts in the preceding quarter will show as a dollar amount on the statement with a description of the services for such fees. This disclosure would only include fees that are above and beyond the net operating investment expenses of the investments.

If applicable, First Mercantile will also add a disclaimer on the quarterly statement that reads, “In addition to the fees and expenses disclosed on the quarterly statement, some of the plan’s administrative expenses for the preceding quarter were paid from the total operating expenses of one or more of the plan’s designated investment alternatives (e.g. through revenue sharing arrangements, Rule 12b-1 fees, sub transfer agent fees).”

For example, if a plan has a 1% asset charge, each participant will see on his or her quarterly statement the dollar portion of such expense and the service to which it relates. If the plan does not have any plan or individual fees deducted, then there would be no fees shown on the quarterly statement. The annual operating expenses of the investments that are used to pay for administrative expenses are shown on the annual disclosure as a percentage and as a dollar amount per \$1,000 investment for each investment option.

### **What should advisors do to get ready for participant fee disclosure?**

Advisors should work closely with their clients and review the existing investment and expense structure and its impact on participant fee disclosure.

By reviewing the existing arrangement, advisors and sponsors can be prepared for any questions that participants may have when they first receive their annual disclosure documents as well as the first quarterly statement that breaks out administrative and individual-related expenses.

This alert is for informational purposes only and should not be construed as legal and/or tax advice. Please consult your own advisor regarding the specific application of the information set forth herein to your own plan.

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