

408(b)(2) PLAN SPONSOR & 404(a)(5) PARTICIPANT  
FEE DISCLOSURE REQUIREMENTS GUIDE

# What You Need to Know and How We Can Help





## Are You Prepared for the Upcoming Regulatory Reform?

ERISA Section 404(a)(5) and 408(b)(2) are part of a three-pronged strategy imposed by the Department of Labor (DOL) to facilitate and enhance the exchange of information between service providers, organizations, their employees and the DOL. The DOL's intent is to improve the disclosure of fees and any conflicts of interest, enabling organizations/plan sponsors to maintain reasonable fees and help employees make better informed investment decisions.



As a plan sponsor and “Responsible Plan Fiduciary,” it is important that you have clarity about the new requirements and are prepared for these changes and conversations. We are here to help. At LPL Financial, our goal is to make sure you have the tools and information you need to maintain best practices and mitigate risk. Toward that effort, we have summarized the new fee disclosure requirements and provided some tools and resources.

## Be Prepared

Along with the sweeping regulatory reform comes unprecedented enforcement by the DOL, which has vowed to make aggressive enforcement a part of the current administration’s agenda. One hundred new enforcers are in place, with an estimated first-year budget of \$153 million for review of the regulation and compliance reviews.<sup>1</sup> ERISA compliance is important, because failure can result in serious penalties. Fiduciaries are subject to strict rules concerning prohibited transactions, and they bear personal liability for breaches. They can be subject to fines of 5% to 100% of the amount of losses incurred, as well as excise taxes, and civil or criminal sanctions. The plan may be disqualified, resulting in the loss of favorable tax treatment for the plan sponsor as well as for plan participants and beneficiaries.

### **No one wants to be the first “example” of this enforcement effort. The best defense is a good offense.**

By April 1, 2012, plan sponsors and retirement plan service providers must comply with the new fee disclosure rules. As a result, plan sponsors and employees will have access to complete information about how much their retirement plans actually cost, as well as descriptions of the services being provided.

Retirement plan fees are complex and challenging to understand. Many surprises lay ahead for plan participants, 70% of whom are under the impression that their plans are “free,” with a high percentage of the remaining pool under the impression their fees are paid by their employer.<sup>2</sup> Furthermore, the number one prompter of a DOL investigation is a phone call from a disgruntled participant.



<sup>1</sup> DOL Fact Sheet – Interim Final Regulation Relating to Improved Fee Disclosure for Pension Plans  
<sup>2</sup> AARP 401(k) Participants’ Awareness and Understanding of Fees Feb 2011

# part 1

## Provider Disclosures to Plan Sponsors (ERISA Section 408(b)(2))<sup>3</sup>

**Beginning April 1, 2012, covered service providers must make certain disclosures to fiduciaries of covered plans.**

**WHICH SERVICE PROVIDERS ARE COVERED?** Those providing services expected to be more than \$1,000:

- To the plan, either as a fiduciary, or as an investment advisor registered under the Investment Advisors Act or state law
- As a fiduciary to an investment that holds plan assets and in which a direct equity investment is made by the plan
- As a recordkeeper or broker providing services to individual account plans where participants direct their own investments, such as a 401(k) plan
- To the plan as accountants, attorneys, actuaries, auditors, third party administrators and others if they expect to receive indirect compensation
- As subcontractors or affiliates to service providers above

**WHAT DISCLOSURES MUST THEY MAKE?** In writing, on behalf of service providers and their affiliates or subcontractors, statements that:

- Describe the services to be provided to the plan
- Disclose their status, if applicable, as a fiduciary or registered investment advisor as registered under state law or the Investment Advisors Act
- Describe the compensation expected to be received, including direct (paid by the plan) and indirect (paid by any source other than the plan or the plan sponsor) compensation, and including a statement that identifies the payer of the indirect compensation and the services for which it is expected to be received
- Describe any compensation payable upon termination of the arrangement
- Describe how the compensation will be paid, for instance, upon receipt of an invoice, through direct deduction, etc.

**WHICH PLANS ARE COVERED?**

Only retirement plans subject to ERISA are covered by the disclosure requirements. These include defined benefit, profit sharing, 401(k) and some 403(b) plans, but not IRAs, Simple IRAs, SEPs, or 403(b)s that are not covered by ERISA.

<sup>3</sup> As of October 25, 2011, the DOL had not published the final rule under 408(b)(2). The final rule could contain further requirements or guidance.

# part 2

## Plan Sponsor Disclosures to Plan Participants (ERISA Section 404(a)(5))

**Plan sponsors must provide certain disclosures to eligible employees and participants in some retirement plans beginning in 2012.**

### What disclosures are required?

Eligible employees and plan participants must receive the following plan-related information in a format that allows for easy comparison:

#### PLAN-RELATED INFORMATION MUST INCLUDE A DESCRIPTION OF:

- When and how a participant may give investment instructions, including any limitations on the instructions (for example, if there are limits placed on transfers to or from a designated investment alternative)
- Any plan provisions that relate to voting rights, tender rights, or similar rights that pertain to investing in a designated investment alternative
- The plan's designated investment alternative
- Who is the plan's designated investment manager
- Self-directed accounts that are available under the plan
- Any brokerage windows in the plan
- Any changes in the listed information, at least 30 days but no more than 90 days before the change becomes effective

#### PLAN-RELATED ADMINISTRATIVE EXPENSE AND FEE INFORMATION

- Fees for general plan administrative expenses that may be charged to participant accounts and that are not shown in the total annual operating expenses of the investment alternatives must be explained. The explanation must include the basis used for allocating the expenses (for example, pro-rata). These might include expenses for recordkeeping or accounting.
- If there are changes in the information provided, an explanation should be provided at least 30 days but not more than 90 days in advance of the change
- Fees and expenses, in dollar amounts, that were actually charged to participant accounts during the previous quarter (or more frequently) for these services. This disclosure must include a description of:
  - The services received in exchange for the expenses
  - A statement explaining whether or not any of the plan's administrative expenses were paid through indirect fees, such as 12b-1 or sub-transfer agency fees



## PLAN-RELATED, PARTICIPANT-SPECIFIC EXPENSE AND FEE INFORMATION

- For expenses and fees that may be charged against an individual participant's account, rather than against the plan as a whole, and that are not shown in the total annual operating expenses of designated investment alternatives, must be explained. These might include fees for plan loans, fees for investment advice, or redemption fees.
- If there are changes in the information, an explanation should be provided at least 30 days but not more than 90 days in advance of the change.
- Fees and expenses, in dollar amounts, that were actually charged to the individual participant's account during the preceding quarter (or more frequently) for these services, along with a description of the services.

## INVESTMENT-RELATED INFORMATION

This information includes the name and type of each designated investment alternative available under the plan, along with performance data, expenses, contact information, comparative data, and a glossary of terms. The required information is very detailed, and is summarized in the DOL's Model Comparative Chart on its website. While the DOL Model Comparative Chart is not required, use of it is designed to ensure compliance. You can view the DOL Model Comparative Chart at [www.dol.gov/ebsa/participantfeerulemodelchart.doc](http://www.dol.gov/ebsa/participantfeerulemodelchart.doc).

For calendar-year plans, the initial disclosure to employees and plan participants is due August 14, 2012.



### When must the disclosures be made?

- The information must be disclosed for the first time on or before the date on which the participant can first direct his or her investments, and again at least once each year
- The initial disclosures must be furnished to participants and beneficiaries of covered plans no later than 60 days after the later of April 1, 2012 or the date they would have been required under the final regulation
- The initial quarterly disclosure must be furnished no later than 45 days after the end of the quarter during which the initial fee disclosures are required to be provided; for calendar-year plans, the initial quarterly disclosure is due August 14, 2012.

### Which plans are subject to the disclosure requirements?

All ERISA-covered individual account plans, like 401(k) and certain 403(b) plans, are subject to the disclosure rules of Section 404(a)(5).

### Things you can start doing today

While all this information may seem overwhelming, there are actionable steps we can guide you through today in an effort to make sure you are well prepared. Our experienced retirement plan advisors at LPL Financial can educate you on the new regulations, help identify covered service providers, gather required information and assist with benchmarking fees, prepare you for participant inquiries and help you manage your risk.

This guide is provided for informational purposes only. It is not intended to provide legal advice or authoritative guidance. Consult with your own attorney for guidance in your particular situation.



# Types of Service Providers and Glossary of Important Terms

## 12b-1 Fees

An implicit fee charged by an investment company and detailed in the prospectus for certain investment choices that are sold as “retail” investments.” 12b-1 fees can be used to compensate brokers and others to cover the cost of promotion, distribution, marketing expenses and commissions.

## Administrative Fees

Occasional fees and explicit fees that are triggered by a participant electing to take a loan or a distribution that covers the cost of processing.

## Advisory Fees

Fees for investment advice and services provided to the plan by a Registered Investment Advisor usually charged as a percentage of assets or flat fee.

## Benchmark

A standardized measure against which the performance of a security, mutual fund or investment manager can be compared. Typically, broad-market stock and bond indexes (such as the S&P 500 Index or Barclays Capital Aggregate Bond Index, respectively) are used for this purpose.

## Bundled Plan

A retirement plan provider that offers a package of investment, custodial, trustee, recordkeeping, administrative and educational services.

## Conflicts of Interest

A situation where a person/entity has a conflict between their self interests and duties.

## Custodian

A financial institution that holds the plans assets and provides services such as cash receipt, disbursements, trading activities and settlement services.

## Plan Trustee

Under ERISA, plan assets are held in a trust. Trustees are appointed by a plan sponsor and/or are named in the plan documents and have the authority to manage and control plan assets. In a participant-directed plan, the participant makes all the investment decisions. In a trustee-directed plan, the trustee makes all the investment decisions.



# Types of Service Providers and Glossary of Important Terms

## Recordkeeper

An administrator that maintains records of participant activity and account balances, and may also provide services for enrollment, managing plan related websites, processing loans and specialized reporting.

## Registered Investment Advisor (RIA)

An RIA provides investment advice or manages the investments of others for a fee and usually does so as a fiduciary. RIAs are not paid commissions from investments.

## Registered Representative/Broker

An individual who is licensed to sell securities. Also called an account executive, a registered representative/broker has more freedom to provide investment advice to employees and plan participants than a plan fiduciary, and can receive commissions from the sale of stocks, bonds or investment products as well as residual compensation from a broker/dealer on the assets of which they are listed as broker of record.

## Surrender Charges

Early redemption fees that are charged in group annuities in the event that a plan is terminated before a certain time period has passed.

## Third Party Administrator (TPA)

A TPA is an independent record-keeper that also provides plan design services, generates reports and statements, including IRS annual filings and required non-discrimination and top heavy testing.

## Unbundled Plan

A retirement plan in which separate companies provide investment, custodial, trustee, recordkeeping, administrative, and educational services.

## Wrap Fees

Usually charged in group annuities, a wrap fee is an implicit fee that bundles together recordkeeping and administrative fees as a percentage of assets. Wrap fees do not include the investment management costs of the underlying investment options or subaccounts.





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