

## Employee Benefits & Executive Compensation ADVISORY

September 29, 2008

### Are You Ready to Bare All?

#### ***DOL Proposed Regulations Require Defined Contribution Plans to Disclose Fee and Investment Information to Participants Beginning January 1, 2009***

The Department of Labor (DOL) has issued proposed regulations that would impose new, specific disclosure requirements on fiduciaries of any defined contribution plan that provides for participant directed investments, regardless of whether the plan is intended to comply with the fiduciary exemption under section 404(c) of ERISA. Some of the proposed requirements will be familiar for section 404(c) plans; however, there are new requirements and compliance deadlines, and the stakes for noncompliance are raised—compliance is required as a matter of fiduciary duty.

The proposed effective date of the new requirements is plan years beginning on and after January 1, 2009. While it's possible the DOL may defer this effective date, the DOL has indicated it intends to finalize the regulations before the end of this year. It's likely that final regulations will be similar to the proposed version in many respects.

It's not too early for plan fiduciaries to consider what they will need to do to comply, including contacting recordkeepers and investment providers to make sure they will be able to provide the necessary information on a timely basis. This advisory highlights key aspects of the proposed regulations and provides a framework for compliance so that plan fiduciaries will be ready to "bare all" of the plan's fee and expense information to plan participants when the regulations are finalized.

### What's A Fiduciary To Do?

The proposed regulation provides detailed rules as to *what* information is to be provided, *when* the information is to be provided and, in certain cases, *how* the information is to be provided.

### What and When?

The type of information required to be disclosed to participants and beneficiaries under the proposed regulation generally falls into two categories:

- (1) plan related information, which includes general information relating to investments available under the plan (such as how investment directions are made and a list of available investment options), and fees and expenses that may be imposed under the plan (including a statement of actual fees charged to each participant's account), and
- (2) investment related information for each investment alternative.

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In general, the time when disclosure must be made varies with the information required to be disclosed:

- General plan and investment information must be provided upon initial eligibility to participate, with at least annual updates (more frequent updates must be provided in the case of certain changes),
- The amount of fees charged against a participant's account must be provided quarterly,
- Information with respect to voting (and similar matters) must be provided after the initial investment is made, and
- Certain additional information must be provided on request.

The table at the end of this advisory lists the information that must be provided and the compliance deadline.

The administrative burdens added under the proposed rules will vary depending on the plan. For example, if a plan's only investment options are mutual funds from a single asset management company and a fixed income investment, the process will be relatively simple. SEC rules generally require mutual funds to provide information to the plan sponsor that will satisfy the proposed regulation and, in this example, the plan sponsor will have to obtain the information from only one or two sources.

For some plans, however, the process will be more difficult, depending on the number and type of investments. One of the reasons for this is the requirement that each investment (other than fixed return investments) be compared to a broad-based "benchmark" investment. In the case of mutual funds, the proposed regulation permits the use of the current benchmark under SEC prospectus requirements (e.g., the appropriate benchmark for a large cap index fund is the S&P 500). However, determining what would be considered an appropriate broad-based benchmark for other investments such as collective trusts, custom-designed investment options, separate accounts or custodial accounts that are not subject to the securities laws, but are often offered as plan investments, may be more difficult because there are no standardized SEC benchmarks for non-mutual fund investment options. More details may be provided in the final regulation.

## **How?**

The proposed regulation requires that investment information be provided to participants in the form of a chart or similar format that is designed to facilitate a comparison of information for each investment alternative. This means that the plan fiduciary cannot simply forward each prospectus but, rather, will need to collect the information for each investment alternative and compile the information in the comparative format. The proposed regulation provides a sample format that is deemed to satisfy the comparative format requirement; other formats may also be used.

Again, the burden of this requirement will vary depending on the plan. In our plan described above, which offers only mutual funds from a single asset management company and a fixed return investment, the asset management company should be able to provide the required information to the fiduciary in a comparative format (most likely the safe harbor format provided by the DOL), to which the information for the fixed return investment should be added.

For other plans, however, the information from multiple sources will need to be compiled by the plan fiduciary and combined into a single comparative document. The plan fiduciary will need to ensure that the format in which the information is provided is sufficiently similar to allow for the appropriate comparison. Many 401(k) plans that include numerous investment options for participants already provide participants with a description of the financial performance of each of the investment options over a multi-year period. This information can serve as the starting point for the single comparative document required by the proposed regulations.

## What If A Fiduciary Doesn't?

Under the proposed rule, compliance with the disclosure requirements is required as a matter of fiduciary duty for any plan that provides for participant-directed investment.

The good news is that compliance with the proposed rules is deemed to be compliance with respect to the general fiduciary requirements of section 404 of ERISA. Thus, the proposed regulations, when finalized, should lay to rest—for the future—the question of how much disclosure is required as a matter of fiduciary duty.<sup>1</sup>

On the negative side, however, the theory of the regulations is that a failure to comply is a breach of fiduciary duty. It is unclear at this point what the consequences of even a minor failure to comply might be. Even minor failures may result in participant claims requesting reimbursement for certain fees or for payment of amounts representing additional investment returns—on the grounds that they never would have invested in a particular investment option if the fees had been properly disclosed. Accordingly, plan fiduciaries should carefully review the information provided to participants and beneficiaries in order to ensure that inadvertent breaches of fiduciary duty do not occur.

The proposed regulation contemplates that plan fiduciaries will need to rely on information provided by third parties and may hire third parties to provide the required disclosures. For many plans, investment related information is already being provided by the plan's recordkeeper. It is expected that most recordkeepers will modify the investment information being provided in order to comply with the proposed rules.

However, as the plan fiduciary is ultimately responsible for compliance, the prudent plan fiduciary should not idly wait for the information to be provided or rely blindly on the information provided. Rather, the proposed regulation would appear to impose on fiduciaries an affirmative obligation to attempt to obtain the required information from service providers and to monitor the service provider's disclosure practices.

## A Framework For Compliance

Following is a list of steps plan fiduciaries can take to help ensure that they are ready for compliance.

### 1. Identify Covered Plans

The proposed regulation applies to *all* plans that provide for participant-directed investment and that are subject to ERISA, regardless of whether the plan is intended to meet the requirements of ERISA Section

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<sup>1</sup> The effect of the proposed regulations on pending fee litigation was addressed in a prior ERISA Litigation Advisory, DOL Proposes Regulations Governing Fee Disclosures to Participants (July 30, 2008); [http://www.alston.com/files/Publication/892b86ad-21c1-42e0-845d-cf919a453a23/Presentation/PublicationAttachment/f04379b1-902d-496a-bfde-d1d14a6f36e1/DOL%20Fee%20Reg%20Advisory%20\(2\).pdf](http://www.alston.com/files/Publication/892b86ad-21c1-42e0-845d-cf919a453a23/Presentation/PublicationAttachment/f04379b1-902d-496a-bfde-d1d14a6f36e1/DOL%20Fee%20Reg%20Advisory%20(2).pdf).

404(c). However, the proposed regulation does *not* apply to self-directed brokerage accounts that allow the participant to select investments other than those offered under the plan.

**Example:** Company X maintains a 401(k) plan that complies with ERISA section 404(c). The 401(k) plan includes eight core investment funds and also offers participants the option of establishing a self-directed brokerage account. Under the proposed rules, the plan fiduciaries are not responsible for disclosing the investment-related information for each investment selected by participants through the self-directed brokerage account option.

## **2. Identify the Fiduciary Who Will be Responsible for Compliance**

The fiduciary who will be responsible for the disclosures should be identified and this responsibility should be reflected in the procedures governing the operation and administration of the plan. Individuals serving as plan fiduciaries should be briefed on the proposed rules to ensure that they understand their obligations.

## **3. Review Summary Plan Descriptions for Plan-Related Information**

Much if not all of the general plan-related information required to be provided (see the attached table for details) may already be included in the current summary plan description (SPD). If the SPD already includes the required information, or may be easily modified to do so, then the SPD may be the most efficient way to satisfy the disclosure requirements upon initial plan eligibility.

The SPD may not, however, be the most efficient means of satisfying the annual disclosure requirement. Most plan sponsors do not provide SPDs annually. Thus, the required annual information will need to be provided separately from the SPD in most cases.

## **4. Identify Third Parties from Whom Information Will Need to be Obtained**

In many cases, the investment-related information required will come from multiple service providers, including the plan's recordkeeper, investment manager for non-mutual fund investments and asset management company for mutual fund investments. If the fiduciary has not done so already, he or she should contact the third party to ensure that they will be able to provide the required information on a timely basis. A list of investment-related information required for each investment alternative is listed on the attached table.

## **5. Provide a Timeline and Format for Compliance**

The proposed regulations require investment-related information to be provided to each participant on or before the date the participant is eligible to participate in the plan. For plans with automatic enrollment, the investment-related information should be provided to the participant with the initial package of information provided to the participant. For plans that do not use automatic enrollment, plan fiduciaries will need to ensure that the investment related information is provided to employees prior to the date they become eligible to participate.

Plan fiduciaries should establish with relevant third parties the time by which the fiduciary will need information from the third party (e.g., so that it can be included in the quarterly statement) and, with respect to investment information that must be provided in a comparative format, the form in which the information needs to be provided (e.g., whether the fiduciary will follow the sample DOL format or use another). Because information regarding fees charged to participant accounts must be disclosed each quarter, an effort should be made to pass through the fees to participants on a timely basis.

## 6. Include Appropriate Contract Terms and Monitor Third Parties

In order to ensure that plan fiduciaries have the information they need, contracts with relevant third parties should reflect the disclosure rules and the information the third party will need to provide to the fiduciary.

### What's Next?

The final regulations hopefully will provide some relief as to the effective date; while nothing is certain yet, the DOL has in the past generally been open to effective dates that provide greater lead time to gear up for compliance.

The DOL regulations may not be the last word on this subject, however. It is expected that Congress, including Congressman George Miller, chairman of the House Committee on Education and Labor, will revisit the fee disclosure issue next year.

While the legislative front bears watching, the more immediate issue for plan fiduciaries remains the DOL proposed regulation. Even if a delayed effective date is provided, fiduciaries should act now in order to be ready to fully “bare all.”

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Time for Providing Information	Information to Be Provided to Participants under the DOL'S Proposed Regulations for Disclosure in Participant Directed Individual Account Plans
On or Before the Date of Initial Plan Eligibility	<p><b>A. Plan-Related Information:</b></p> <p><b>1. General Plan Information</b></p> <ul style="list-style-type: none"> <li>An explanation of the circumstances under which participants may give investment instructions.</li> <li>An explanation of any limitations on such instructions, including any restrictions on transfer to or from a designated investment alternative.</li> <li>A description of, or reference to, plan provisions relating to the exercise of voting, tender and similar rights arising from plan investments.</li> <li>An identification of the plan's designated investment alternatives.</li> <li>An identification of any designated investment managers.</li> </ul> <p><b>2. Expense and Fee Information</b></p> <ul style="list-style-type: none"> <li>An explanation of plan administrative expenses that may be charged to the plan.</li> <li>An explanation of any fees and expenses that may be charged against an individual account rather than on a plan basis (e.g., loan processing fees).</li> </ul> <p><b>B. Investment-Related Information for Each Investment Alternative:</b>  <b>NOTE: This information must be provided in a comparative format.</b></p> <ul style="list-style-type: none"> <li>Identifying information, including the name of the investment, a web site address where additional specified information can be obtained, the type or category of the investment (e.g., money market, balanced) and the type of management (e.g., passive or active).</li> <li>Performance data for the past 1-year, 5-year and 10-year periods.</li> <li>The name and returns of a benchmark broad-based securities market index.</li> <li>Amount and description of each shareholder-type fee (i.e., fees charged directly against a participant's investment, such as sales loads and redemption fees).</li> <li>Total annual operating expenses, expressed as a percentage.</li> <li>A statement indicating that the fees and expenses are only one of several factors participants should consider.</li> </ul>
Within 30 Days of Adoption of Material Changes	A description of any changes relating to the general plan-related information described in A.1., above.
Quarterly (May Be Included with Quarterly Benefit Statement)	<ul style="list-style-type: none"> <li>A statement including the dollar amount actually charged to the participant's account during the preceding quarter for <i>plan administrative expenses</i> and a description of the services provided.</li> <li>A statement including the dollar amount actually charged during the preceding quarter to the participant's account for <i>individual services</i> (e.g., loan processing fees) and the description of the services provided.</li> </ul>
After an Investment Is Made	Any materials provided to the plan relating to the exercise of voting, tender and similar rights to the extent such rights are passed along to plan participants.
Once Every 12 Months	Current version of plan-related and investment-related information that is required to be provided on or before initial plan eligibility, as described above.
Upon Request	Prospectuses, financial statements that are provided to the plan, a statement of the value of a share or unit and a list of assets comprising the portfolio of investment alternatives that constitute plan assets.

\* This summary describes information required with respect to investments that do not offer a fixed rate of return; different information is required with respect to investments that offer a fixed rate of return.



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