

MEMO# 24702

November 11, 2010

DOL Issues Final Participant Disclosure Regulations; ICI to Host Webinar on December 1

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TO: PENSION MEMBERS No. 49-10
TRANSFER AGENT ADVISORY COMMITTEE No. 76-10
BANK, TRUST AND RECORDKEEPER ADVISORY COMMITTEE No. 49-10
BROKER/DEALER ADVISORY COMMITTEE No. 56-10
OPERATIONS COMMITTEE No. 37-10 RE: DOL ISSUES FINAL PARTICIPANT DISCLOSURE
REGULATIONS; ICI TO HOST WEBINAR ON DECEMBER 1

NOTE: The Institute will host a webinar on December 1 on the new Department of Labor participant disclosure regulations, with a focus on the challenges for mutual funds used as investments in 401(k) and other defined contribution plans. For more information, go to http://www.ici.org/events/upcoming/webinar_10_erisa. To register for the webinar, go to <http://members.ici.org/reg/webinar/erisa>.

The Department of Labor issued final rules requiring disclosure of certain plan and investment- related information to participants in participant-directed defined contribution plans. [1] The Department responded favorably to almost all of the suggestions the Institute made in its comment letter. [2] The final rules implement a long-standing Institute priority that participants in 401(k) and similar plans receive key investment information on the investments on the plan's menu, regardless of type of investment. [3]

The new rules require that participants receive basic information on the plan and its designated investment options prior to the date they can direct the investment of their account and annually thereafter, with access to more information online and upon request, and require that expenses charged to a participant's account at the plan level for administrative services be disclosed quarterly. These requirements apply under ERISA's general fiduciary rules and regardless of whether or not the plan is an ERISA section 404(c) plan. Participants receive a comparative chart (using a DOL model included as an appendix

or other comparative format) on the plan's investment options and would receive copies of prospectuses (including summary prospectuses) upon request. The obligation to provide the information is on the plan administrator.

Structure of the Rule

DOL added a new regulation (29 C.F.R. § 2550.404a-5) under the general fiduciary duty rules of ERISA that would interpret section 404(a) to require fiduciaries of participant-directed defined contribution plans to take steps to ensure that participants, on a regular and periodic basis, are made aware of their rights and responsibilities and are provided sufficient information regarding the plan's designated investment alternatives. The bulk of the regulation sets out what fiduciaries must do to comply with this disclosure obligation. DOL also amended its existing regulation under section 404(c) of ERISA to harmonize the new general disclosure requirements with what is required to comply with section 404(c).

The regulation covers any ERISA-governed individual account plan that is participant-directed, but DOL specifically exempted IRA-based plans like SEP and SIMPLE IRAs.

The disclosure is divided into two parts:

- plan related information, such as general information about how to give investment directions, information on administrative expenses, and information on expenses for specific services; and
- investment-related information.

Generally, the information must be based on the latest information available to the plan and written in a manner calculated to be understood by the average participant. Except as noted below, fees and expenses can be expressed in terms of a monetary amount, formula, percentage of assets, or per capita charge.

Disclosure of Plan-Related Information

Before first investment decision and annually thereafter. Plan-related information must be provided on or before the date that a participant can first direct the investment of his or her account. [\[4\]](#)

This includes:

1. an explanation of the circumstances under which participants may give investment instructions;
2. an explanation of any specified limitations on instructions under the terms of the plan, including any restrictions on transfer to or from a designated investment alternative;
3. a description of or reference to plan provisions relating to the exercise of voting, tender and similar rights appurtenant to an investment in a designated investment alternative as well as any restrictions on these rights;
4. an identification of any designated investment alternatives offered under the plan;
5. an identification of any designated investment managers;
6. a description of any brokerage windows or similar arrangement;
7. an explanation of any fees and expenses for general plan administrative services that, to the extent not included in any investment-related fees and expenses, may be charged to the plan, and the basis for allocation (e.g., pro rata, per capita) to individual accounts; and

8. an explanation of any fees and expenses that may be charged against an individual account for services provided on an individual, rather than plan, basis (such as fees attendant to loans, QDROs, investment advice or brokerage windows, commissions, loads, sales charges, or redemption fees, and optional riders in annuity contracts).

If any of this information changes, the participant must be informed at least 30 days, but not more than 90 days, in advance of the effective date of a change in this information, unless the inability to provide advance notice is due to events that were unforeseeable or circumstances beyond the control of the plan administrator, in which case notice must be furnished as soon as reasonably practicable.

DOL states that this information may be provided as part of the summary plan description or as part of the quarterly benefit statement, provided the timing requirements are met. Plan fiduciaries may satisfy the requirements for new participants by furnishing the most recent annual information provided to existing participants plus any updated information provided since the last annual disclosure.

Quarterly. At least quarterly, participants must be furnished a statement that includes the dollar amount actually charged (formulas are not allowed) during the preceding quarter for plan or individual administrative expenses (items 7 and 8 above), and, for individual services (item 8), a description of the services provided to participants for the charges. DOL states that this information may be provided as part of the quarterly benefit statement. In addition, the regulation includes a new requirement that participants be told quarterly, if applicable, that some of the plan's administrative expenses for the preceding quarter were paid from the total annual operating expenses of one or more of the plan's designated investment alternatives. [\[5\]](#)

Disclosure of Investment-Related Information

Under the rule, investment-related information is in three parts—information provided upon eligibility and annually thereafter, information provided subsequent to investment, and information provided upon request.

Before first investment and annually thereafter. For each designated investment alternative, the participant must be furnished identifying information, performance information, fee and expense information, supplemental web site information, a glossary, and additional information on annuity products. New participants may be provided the most recent annual disclosure.

Identifying information. The disclosure must include the name of the designated investment alternative and the type or category of the investment (e.g., money market fund, balanced (stocks and bonds) fund, large cap stock fund, employer stock fund).

Performance information. For a variable return product like a mutual fund, the disclosure must include the average annual total return [\[6\]](#) of the investment for the 1-, 5-, and 10-calendar year periods (or for the life of the alternative, if shorter [\[7\]](#)) ending on the date of the most recently completed calendar year. It must include a statement that an investment's past performance is not necessarily an indication of how the investment will perform in the future. In addition, the disclosure must include the name and returns of an appropriate broad-based securities market index over the comparable 1-, 5-, and 10-calendar year periods (or for the life of the alternative, if shorter) which is not administered by an affiliate of the investment issuer, its investment adviser, or a principal underwriter,

unless the index is widely recognized and used. In response to a comment from the Institute, DOL clarified in the preamble that additional benchmarks may be provided, so long as the additional information is not inaccurate or misleading. The preamble gives as an example a blended return of more than one broad-based index to compare to a balanced fund.

If the designated investment has a return that is fixed or stated for the term of the investment, different information is required. The plan administrator must disclose both the fixed or stated annual rate of return and the term of the investment. If the issuer reserves the right to adjust the fixed or stated rate of return prospectively during the term of the contract or agreement, the disclosure must include the current rate of return, the minimum rate guaranteed under the contract, if any, and a statement advising participants and beneficiaries that the issuer may adjust the rate of return prospectively and how to obtain (e.g., telephone or web site) the most recent rate of return.

Fee and expense information. The required disclosure of fee and expense information must describe the amount and a description of each shareholder-type fee (i.e., fees charged directly against a participant's investment), [8] and any restriction or limitation that may be applicable to a purchase, transfer, or withdrawal of the investment (such as a round trip or equity wash restriction). The disclosure must state the total annual operating expenses of the investment expressed as a percentage (e.g., expense ratio) [9] and the expense ratio expressed as dollar amount for a \$1,000 investment. [10] For purposes of this \$1,000 example, no returns are assumed.

The disclosure must include a statement that the cumulative effect of fees and expenses can substantially reduce the growth of a participant's or beneficiary's retirement account and that participants and beneficiaries can visit the Employee Benefits Security Administration's web site for an example demonstrating the long-term effect of fees and expenses.

For fixed return investments, the fee and expense disclosure must provide the amount and a description of any shareholder-type fees and a description of any restriction or limitation that may be applicable to a purchase, transfer or withdrawal of the investment in whole or in part.

Supplemental web site information. For each designated investment alternative, participants must be given a specific web site address that includes: the name of the investment's issuer; the investment's objectives or goals, principal strategies (including a general description of the types of assets held by the investment [11]) and principal risks, the investment's portfolio turnover, [12] performance data updated at least quarterly, [13] and the investment's fee and expense information. The disclosure of objectives or goals, principal strategies and risk, and portfolio turnover must be done in a manner consistent with SEC Form N-1A or N-3, as appropriate. [14] As the Institute had urged, the regulation does not mandate a format for web site presentation.

Glossary. The plan administrator must provide participants with a general glossary of terms to assist in understanding the designated investment alternatives, or a web site where the glossary is located. DOL states in the preamble that it decided against preparing a glossary because plan administrators working with their service providers are in the best position to determine the glossary. DOL asks for comments on whether DOL should develop a glossary that could be used by plan administrators and, if so, what terminology should be addressed.

Additional information on annuities. If the investment is part of a contract, fund or product that permits participants or beneficiaries to allocate contributions toward the future purchase of a stream of retirement income payments guaranteed by an insurance company, additional information must be provided. This includes the benefits and factors that determine the price of the guaranteed income product, any limitations on the ability, or fees, to withdraw or transfer amounts allocated to the option (e.g., lock-ups); any fees that will reduce the value of the option, such as surrender charges, market value adjustments, and administrative fees; a statement that guarantees of an insurance company are subject to its long-term financial strength and claims paying ability; and a web site address that provides additional information.

Comparative format. The above information must be presented in a format designed to facilitate a comparison for each designated investment alternative. The comparative format must include the date and the name, address and telephone number of the person to contact for information available upon request. The comparative format must also include a statement that additional investment-related information (including more current performance information) is available at the listed web site addresses and explain how to obtain the web site information in paper format free of charge.

DOL provided a model chart that, if used, will satisfy the comparative format requirement. [\[15\]](#) Use of the model chart is not required, and the regulation states that a plan administrator may include additional information appropriate for comparison, so long as the additional information is not inaccurate or misleading.

Information provided subsequent to investment. Participants must be provided any materials provided to the plan relating to the exercise of voting, tender, and similar rights appurtenant to the investment, to the extent participants have these rights under the plan.

Information provided upon request. Participant must be provided upon request:

- copies of prospectuses (or any short-form or summary prospectus approved by the SEC) for entities registered under either the Securities Act of 1933 or the Investment Company Act of 1940, or similar documents relating to designated alternatives that are provided by unregistered entities; [\[16\]](#)
- copies of any financial statements or reports, such as statements of additional information and shareholder reports, and any other similar materials relating to the plan's designated investment alternatives, to the extent the materials are provided to the plan;
- a statement of the value of a share or unit of each designated investment alternative as well as the date of the valuation; and
- a list of the assets comprising the portfolio of each designated investment alternative that constitute plan assets and the value of each such asset (or the proportion of the investment that it comprises). [\[17\]](#)

Rules for Specific Investment Types

The regulation includes special disclosure rules that apply to designated investment options that are qualifying employer securities, annuities, and fixed return investments. [\[18\]](#) For example, the rule includes different disclosures for qualifying employer securities relating to principal strategies and risks, fee and expense information, and performance data. In the model chart, DOL places annuities and fixed return investments in separate sections. The regulation also reserves a section for special rules related to target date and similar

funds. DOL intends to publish a separate notice of proposed rulemaking that would supplement the rule's requirements for designated investment alternatives that are target date-type funds.

The regulation includes a few special rules for variable return investments not registered under the Investment Company Act of 1940. First, the definition of total annuity operating expenses (i.e., the expense ratio) is slightly modified from the definition in Form N-1A. Second, the regulation includes a transition rule for reporting of historical performance for these investments for plan years beginning before October 1, 2021 if the plan administrator determines that it does not have the expense information to calculate the 5- and 10-year performance. Instead, the plan may use the most recently reported total annual operating expenses of the designated investment alternative as a substitute for such expenses. When a plan administrator uses a reasonable estimate or the most recently reported total annual operating expenses as a substitute for actual expenses, the administrator must inform participants of the basis on which the returns were determined.

Electronic Disclosure

The Institute and others had applauded DOL for using a layered, web-based approach in the proposal but had also urged DOL to enhance further the ability of plans to use electronic delivery. DOL reserved a section of the regulation on this issue and states in the preamble that it is exploring whether, and possibly how, to expand or modify the standards applicable to the electronic distribution of required plan disclosures. DOL states it will, in the near future, request public comment on the issue and anticipates that resolution of this issue will occur in advance of the compliance date.

Economic Analysis

The Institute's comment letter, while strongly agreeing that the proposal would have significant benefits justifying its costs, disagreed with DOL's conclusion that plan participants pay, on average, fees that are higher than necessary by 11.3 basis points. We included a detailed appendix explaining why DOL had misinterpreted the statistics in the studies it had cited, misapplied some of those studies to 401(k) plans, and failed to recognize empirical difficulties in the studies cited. In response, DOL refined and strengthened its analysis. DOL concludes that "the estimate that [fees] are on average 11.3 basis points higher than necessary lacks adequate basis and should be disregarded."

Section 404(c) Changes

DOL also amended the existing 404(c) regulation, 29 C.F.R. § 2550.404c-1, largely as proposed, to establish a uniform disclosure framework for all participant-directed individual account plans. For example, references to investment information that must be provided automatically or upon request were replaced with cross-references to the new rules. Other requirements of the section 404(c) regulation, such as the requirement to offer at least three diversified investment alternatives with materially different risk and return characteristics, still apply.

DOL included in the 404(c) regulation a statement that ERISA section 404(c) does not relieve a fiduciary from the duty to prudently select and monitor any service provider or designated investment alternative. This reflects the long-standing view of DOL, which previously had been expressed formally only in a footnote in the preamble to the previous

final section 404(c) regulation. [19] DOL also included a similar statement in the main participant disclosure regulation.

Effective Date

The regulation is effective on December 20, 2010, but the applicability date – the date by which plans must comply – is plan years beginning on or after November 1, 2011. Therefore, the rules will apply to calendar year plans on January 1, 2012. For existing participants, information must be furnished no later than 60 days after the applicability date.

Michael L. Hadley
Associate Counsel

endnotes

[1] A copy of the final regulation is available here: <http://webapps.dol.gov/FederalRegister/PdfDisplay.aspx?DocId=24323>. For a description of the proposed regulation, see [Memorandum](#) to Pension Members No. 44-08, Transfer Agent Advisory Committee No. 36-08, Bank, Trust and Recordkeeper Advisory Committee No. 22-08, Broker/Dealer Advisory Committee No. 23-08 and Operations Committee No. 12-08 [22742], dated July 29, 2008.

[2] See [Memorandum](#) to Pension Members No. 52-08, Transfer Agent Advisory Committee No. 49-08, Bank, Trust and Recordkeeper Advisory Committee No. 29-08, Broker/Dealer Advisory Committee No. 31-08 and Operations Committee No. 17-08 [22854], dated September 9, 2008.

[3] The Institute's Board of Governors adopted a policy statement in January of 2007 reiterating this goal. For a copy of the Institute's Policy Statement, see http://www.ici.org/pdf/ppr_07_ret_disclosure_stmt.pdf.

[4] The proposal required the initial information be provided at or before eligibility to participate in the plan. The Institute suggested DOL revise the timing requirement to accommodate plans with immediate eligibility.

[5] DOL gives as examples revenue sharing arrangements, 12b-1 fees, and sub-transfer agent fees.

[6] Generally, performance data is calculated in the way mutual funds already disclose it. Average annual return means the average annual compounded rate of return that would equate an initial investment in a designated investment alternative to the ending redeemable value of that investment calculated with the before tax methods of computation prescribed in SEC Form N-1A, N-3, or N-4, as appropriate, except that the computation may exclude any front-end, deferred or other sales loads that are waived for the participants of the plan. This latter exception was added in response to a comment from the Institute.

[7] This was added to the regulation in response to a comment from the Institute.

[8] DOL gives as examples of "shareholder-type fees" the following: sales loads, sales

charges, deferred sales charges, redemption fees, surrender charges, exchange fees, account fees, and purchase fees.

[9] DOL defines total annual expenses as the annual operating expenses and other asset-based charges before waivers and reimbursements (e.g., investment management fees, distribution fees, service fees, administrative expenses, separate account expenses, mortality and expense risk fees) that reduce the investment's rate of return, expressed as a percentage, calculated in accordance with the required SEC form, e.g., Form N-1A (open-end management investment companies) or Form N-3 or N-4 (separate accounts offering variable annuity contracts).

[10] The Institute's comment letter recommended an illustrative example along these lines instead of individualized dollar-based disclosures for investment-based fees.

[11] The proposal had suggested that the actual holdings of the investment must be disclosed, and the Institute asked DOL to clarify that the web site information includes a description of the type of assets in the portfolio, not a list of securities in the portfolio.

[12] In response to a comment from the Institute, DOL clarified that portfolio turnover should be calculated consistent with Form N-1A and that money market funds (and other investment products with similar investment objectives) may omit a portfolio turnover rate.

[13] Performance data must be updated more frequently than quarterly if required by "other applicable law."

[14] In response to a technical comment from the Institute, DOL clarified that any cross-references to SEC rules, forms and instructions will refer, as appropriate, to successor rules and instructions.

[15] A copy of the model chart in Word format is available here:
<http://www.dol.gov/ebsa/participantfeerulemodelchart.doc>.

[16] While this information is similar to that previously required under section 404(c), one significant change is that mutual fund prospectuses are now required only upon request, and not automatically upon the participant's initial investment.

[17] Note that this rule does not apply to the portfolio holdings of mutual funds, which are not considered "plan assets."

[18] DOL states in the preamble that while money market mutual funds and stable value funds generally aim to preserve principal, they are not free of investment risk to the investor and therefore are not considered "fixed return investments."

[19] DOL also has taken this position repeatedly in litigation.