The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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DOL Issues Supplemental Guidance on Participant Disclosure Rules

[26153]

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TO: PENSION MEMBERS No. 21-12
BANK, TRUST AND RETIREMENT ADVISORY COMMITTEE No. 22-12 RE: DOL ISSUES SUPPLEMENTAL GUIDANCE ON PARTICIPANT DISCLOSURE RULES

The Department of Labor issued Field Assistance Bulletin 2012-02, [1] which provides answers to frequently asked questions (FAQs) regarding implementation of the participant-level disclosure regulation (29 C.F.R. §2550.404a-5). [2] There are 38 FAQs covering the following topics:

- Scope – Covered Individual Account Plan;
- Disclosure of Plan-Related Information – General Information, Administrative Expenses, Brokerage Windows, and Individual Expenses;
- Disclosure of Investment-Related Information – Generally, Benchmarks, Internet Web Site Address, Glossary, Comparative Format, and Information to be Provided Upon Request;
- Form of Disclosure;
- Definitions (Designated Investment Alternatives, Brokerage Windows, and Total Annual Operating Expenses);
- Compliance Dates and Transitional Rules; and
- Amendments to the 404(c) Regulation.

The guidance addresses many issues the Institute has raised with DOL since publication of the final regulation in 2010, including the following:

- Designated investment alternatives closed to new investments. FAQ 15 explains that plan administrators must provide the investment-related information for designated investment alternatives (DIAs) that are closed to new investments but in which participants are permitted to maintain prior investments and transfer the prior investments to other DIAs. However, a plan administrator could choose to provide the information about the closed DIA as part of a comparative document furnished only to those participants who remain invested in that DIA.
- Providing optional blended benchmarks for balanced funds. FAQ 16 states that a plan

administrator may use the target asset allocation of the DIA to determine the weightings of the indexes used to create the additional blended benchmark, as long as the target is representative of the actual holdings of the DIA over a reasonable period of time. The reasonableness of the time period depends on facts and circumstances, but a period that is the same as that covered by the benchmark returns (e.g., 1-, 5-, or 10-years) would not be unreasonable, according to the guidance. In addition, whether the target allocation is representative of the actual holdings of the DIA depends on facts and circumstances, but target percentages ordinarily would be representative of the actual holdings if "nearly equal" to the daily average of the DIA's ratios of stocks and bonds over a reasonable period of time.

- Providing multiple charts supplied by various service providers. FAQ 21 clarifies that, in cases where a plan has multiple service providers or investment issuers, plan administrators may furnish multiple comparative charts or documents, as long as all of the charts or documents are furnished to participants at the same time in a single mailing or transmission, and as long as the charts or documents are designed to facilitate comparison among the plan's DIAs.
- Inclusion of "since inception" performance and benchmark data. FAQ 24 clarifies that "since inception" data is required only for DIAs that have been in existence for less than 10-years, despite the inclusion of the reference to"since inception" data for all DIAs on the DOL's model comparative chart.

Mutual Fund Windows

One of the most notable FAQs addresses whether a mutual fund available on a mutual fund investment platform (also known as a mutual fund window), or the platform itself, is a DIA. In FAQ 30, DOL clarified that the platform itself would not be a DIA, but the individual mutual funds would be DIAs if they are specifically identified as available under the plan. Significantly, DOL announced that, pending further guidance in this area, when a platform holds more than 25 investment alternatives, DOL will not require (as a matter of enforcement policy) that all of the investment alternatives be treated, for purposes of the participant disclosure regulation, as DIAs if the plan administrator—

(1) makes the required disclosures for at least three of the investment alternatives on the platform that collectively meet the "broad range" requirements in the ERISA 404(c) regulation (29 CFR § 2550.404c-1(b)(3)(i)(B)); [3] and

(2) makes the required disclosures with respect to all other investment alternatives on the platform in which at least five participants and beneficiaries, or, in the case of a plan with more than 500 participants and beneficiaries, at least one percent of all participants and beneficiaries, are invested on a date that is not more than 90 days preceding each annual disclosure.

The answer to FAQ 30 also raises questions about a plan fiduciary's ability to meet its obligations under ERISA where no effort is made to narrow the availability of investments offered on a platform. In this respect, FAQ 30 states that "[a]lthough the regulation does not specifically require that a plan have a particular number of designated investment alternatives, the failure to designate a manageable number of investment alternatives raises questions as to whether the plan fiduciary has satisfied its obligations under section 404 of ERISA . . . If, through a brokerage window or similar arrangement, non-designated investment alternatives available under a plan are selected by significant numbers of participants and beneficiaries, an affirmative obligation arises on the part of the plan

fiduciary to examine these alternatives and determine whether one or more such alternatives should be treated as designated for purposes of the regulation."

Designated Investment Managers

FAQ 4 explains how a "designated investment manager" (DIM) differs from a DIA for purposes of identifying the DIMs and DIAs offered under the plan as part of the disclosure of plan-related information to participants. According to the FAB, a DIM is an ERISA section 3(38) investment manager that is designated by a plan fiduciary and made available to participants and beneficiaries to manage all, or a portion of the assets held in, or contributed to, their individual accounts. In addition, when participants appoint a DIM to manage all or a portion of their individual accounts, the DIM becomes responsible for investing their accounts on a participant-by-participant basis.

On a related topic, FAQ 27 explains that when a plan designates a fiduciary investment manager, within the meaning of ERISA section 3(38), whom participants may appoint to allocate the assets in their individual accounts among the plan's existing DIAs based on an investment strategy determined by the investment manager to be appropriate for that participant (taking into account the participant's age, time horizons, risk tolerance, current investments, sources of income, and investment preferences) the investment management service is not a DIA under the participant disclosure regulation. [4]

Model Portfolios

FAQ 28 provides some clarification regarding the status of a model portfolio as a DIA. In the example provided, a plan offers three model portfolios (labeled "conservative," "moderate," and "growth") made up of different combinations of the plan's DIAs. In this regard, DOL states that a model portfolio ordinarily is not required to be treated as a DIA if it is clearly presented to participants as merely a means of allocating assets among different DIAs. However, if the participant in choosing the model portfolio acquires an equity security, unit participation, or similar interest in an entity that itself invests in some combination of the plan's DIAs, the model portfolio would be considered a DIA.

FAQ 28 goes on to explain that when a model portfolio is simply a means of allocating account assets among specific DIAs, the plan administrator must clearly explain how it differs from the plan's DIAs. On the other hand, if a plan offers only model portfolios made up of investments not separately designated under the plan, each model is to be treated as a separate DIA. Finally, DOL notes that, while model portfolios ordinarily are not required to be treated as DIAs, plan administrators may include on the comparative chart additional information that the plan administrator deems appropriate as long as the information is not inaccurate or misleading.

Transition Period

Prior to publication of FAB 2012-02, the Institute requested a limited period of transition relief for covered service providers and plan administrators with respect to both the participant-level disclosure regulation and the service provider disclosure regulation at 29 C.F.R. §2550.408b-2. [5] Specifically, the Institute recommended that DOL issue guidance stating that a service provider or plan administrator would be viewed as meeting the requirements of the 408b-2 and 404a-5 regulations, respectively, if for the transition period, the service provider or plan administrator relied (a) on a reasonable and good faith

interpretation of the regulations or (b) on the regulations as interpreted by the FAQs.

In FAQ 37, DOL recognizes that it may be difficult or costly for plan administrators and service providers to make further system adjustments (to comply with interpretations set forth in the FAB) in advance of the July 1, 2012 service provider disclosure regulation effective date and the August 30, 2012 deadline for initial participant disclosures. Nevertheless, in light of the significance of the required disclosures and their already delayed implementation, [6] DOL does not believe that further broad-based extensions are appropriate. For enforcement purposes, however, DOL will take into account whether covered service providers and plan administrators have acted in good faith based on a reasonable interpretation of the new regulations. If they have acted in good faith based on a reasonable interpretation of the new regulations, enforcement actions would generally be unnecessary if the covered service provider or plan administrator, as applicable, also establishes a plan for complying with the requirements of the FAB in future disclosures.

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endnotes

[1] The FAB is available here: http://www.dol.gov/ebsa/pdf/fab2012-2.pdf. In a related news release, DOL stated that a forthcoming second set of FAQs will focus more narrowly on the 408(b)(2) service provider disclosure rules. The news release is available here: http://www.dol.gov/ebsa/newsroom/2012/EBSA050712.html.

[2] See Memorandum 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, and Operations Committee No. 37-10 [24702], dated November 11, 2010.

[3] The DOL regulation under ERISA section 404(c) describes a broad range of investment alternatives, in relevant part, as providing participants a reasonable opportunity to choose from at least three investment alternatives: (1) each of which is diversified, (2) each of which has materially different risk and return characteristics, (3) which in the aggregate enable the participant to achieve a portfolio with aggregate risk and return characteristics at any point within the range normally appropriate for the participant, and (4) each of which when combined with investments in the other alternatives tends to minimize through diversification the overall risk of a participant's portfolio. 29 CFR § 2550.404c-1(b)(3)(i)(B).

[4] The FAB notes, however, that a plan administrator must identify the designated investment manager, provide plan-level information regarding fees associated with the service and provide participants with a statement, at least quarterly, of the dollar amount of fees and expenses that actually were charged against their individual accounts together with a description of the services to which the charges relate.

[5] See Memorandum to Pension Members No. 18-12 [26086], dated April 26, 2012; see Memorandum to Pension Members No. 7-12, Operations Committee No. 3-12, Bank, Trust

and Retirement Advisory Committee No. 5-12, Broker/Dealer Advisory Committee No. 4-12, and Transfer Agent Advisory Committee No. 6-12 [25868], dated February 6, 2012.

[6] See Memorandum to Pension Members No. 40-11, Operations Members No. 14-11, Bank, Trust and Recordkeeper Advisory Committee No. 41-11, and Transfer Agent Advisory Committee No. 55-11 [25330], dated July 14, 2011.
