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BENEFITS BRIEF

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DOL Field Assistance Bulletin 2012-02 – Participant Disclosure FAQs

On Monday, May 7, 2012, the Department of Labor ("DOL") released Field Assistance Bulletin 2012-02 (attached) which presents the DOL's responses to frequently asked questions ("FAQs") under its participant disclosure rules that go into effect this year. As you may know, these rules (the "404a-5 Rules") require plan administrators of participant-directed individual account plans to provide detailed initial and ongoing disclosures to the plan's participants that address plan fees and expenses, the plan's designated investment alternatives ("DIAs"), and other information. *See* 29 C.F.R. § 2550.404a-5. These rules apply generally to all ERISA-covered participant-directed individual accounts plans, including 403(b) plans as well as so-called ERISA section "404(c) plans."

DOL has been gathering questions from the regulated community related to the 404a-5 Rules since they were issued in final form in October of 2010. In this FAB, the DOL presents thirty-eight frequently asked questions. We know that DOL is separately working on a project to provide additional guidance, also likely in FAQ form, under its service provider disclosure, or section 408(b)(2), regulation (the "408(b)(2) Regulation"). DOL intends to issue the 408(b)(2) Regulation guidance later, we hope before the July 1st disclosure deadline. As you may know, we have been working with the DOL staff on some of the 408(b)(2) questions it is now considering.

The FAB responds to many of the questions that we have been hearing from both our service provider and plan sponsor clients. Here we present highlights of DOL's guidance.

1. Compliance Deadline / Enforcement Relief

- DOL did not extend the compliance deadline for initial disclosures under the regulation, despite the hopes and specific requests of many recent commenters. Specifically, FAQ 35 reiterates that plans are required to provide the initial disclosures no later than the later of (1) 60 days following July 1, 2012 (the date that the revised 408(b)(2) Regulation becomes effective), or (2) 60 days following the first day of the first plan year that begins after November 1, 2011. Accordingly, for most plans, the initial disclosures must be furnished to participants and beneficiaries (including those who are eligible but opted out of plan participation) by August 30, 2012. Q-35.

- Although we understand that DOL is aware that many plan sponsors have already delivered disclosures to participants, DOL did not offer broad-based compliance relief for already delivered disclosures that may be inconsistent with the guidance set forth in the FAB. Rather, in FAQ 37, DOL indicated that enforcement actions would not be necessary for plan administrators whose disclosures do not meet the terms of the FAB if the administrator acted in good faith based on a reasonable interpretation of the regulation and creates a plan for complying with the FAB in future disclosures. Q-37.

2. <u>Designated Investment Alternatives:</u> The term "DIA" is a key term under the 404a-5 Rule because certain investment-related disclosures are required for each DIA. DOL addressed the definition of "DIA" in several FAQs.

- In a surprising pronouncement, DOL addressed plans that may select a platform provider that offers a large number of investment options but do not separately "designate" any of the platform's options as available for participants. DOL made clear that the platform itself is not DIA; nonetheless, DOL cautioned that the failure to designate a manageable number of investment alternatives may raise questions as to whether the plan fiduciary has satisfied his general fiduciary duties under ERISA section 404. Moreover, the DOL added that if a "significant" number of participants select a non-designated option (including through a brokerage window), an affirmative obligation could arise on the part of the plan fiduciary to determine whether it should be treated as a DIA. Further, DOL stated that if a platform consists of more that 25 investment alternatives, the DOL will not require each alternative be treated as a DIA, provided that at least three of the options that would satisfy the "broad range" requirement of ERISA section 404(c), and any other option selected by a threshold number of the plan's participants, are treated as DIAs under the 404a-5 Rule. DOL's guidance here surprises us for a number of reasons, including its suggestion that plan administrators may have a new duty to monitor the number of participants who select specific securities under a brokerage window. Q-30.

- DOL made clear that so-called "frozen" investment options, or options that are currently closed to new investments, must be included in the plan's comparative chart that provides DIA information. Q-15.

- DOL made clear that, generally, model portfolios that are essentially allocation methodologies across the plan's existing DIAs are not themselves DIAs where participants do not acquire units of participation in an investment entity (such as a trust or fund) that itself invests in the plan's DIAs. Accordingly, unique performance and fee data for these asset allocation models would ordinarily not have to be developed for purposes of complying with the 404a-5 Rules. Nonetheless, DOL made clear that, regardless of whether the model portfolio is a itself DIA, how the model portfolio works and how it differs from the plan's other investment options should be clearly described to participants. DOL also made clear that if the model portfolio involves a participant receiving interests in a unitized fund that itself invests in the plan's DIAs, or if a plan offers model portfolios made up of investments that are not otherwise DIAs under the plan, then each such model portfolio should be treated as a separate DIA, subject to disclosure on the plan's comparative chart. Also, DOL indicated that plan administrators have the discretion to treat model portfolios as DIAs for purposes of the comparative chart if they choose to and provide information that is not misleading or inaccurate. Q-28.

3. <u>Administrative Expense Disclosures:</u> The FAQs clarify several issues relating to requirements to the disclosure of expenses charged to plan and participant accounts.

- DOL confirmed that disclosures of plan administrative expenses must generally include a description of the specific amount that would be charged against a participant's account, as well a description of the services and the allocation method, where the fees are known at the time of the disclosure. Q-5.

- Fees paid from plan forfeiture accounts or from the plan sponsor are not required to be identified as plan administrative expenses. Q-7.

4. Investment Performance and Expense Disclosures

- DOL clarified that the performance information that must be included on the plan's website for variable return DIAs is generally rolling 1-, 5- and 10- year performance information for the period ending on the most recent calendar quarter end. Other performance information, such as year-to-date return information, may be provided in addition on the website, as long as the information is not inaccurate or misleading. Q-19.

- DOL clarified that the comparative chart of DIA information may provide more recent 1-, 5- and 10-year performance data than the end of the most recent calendar year. Accordingly, performance information on the comparative chart can be stated as of the most recent calendar quarter end. Nonetheless, DOL cautioned that the stated performance period should ordinarily be the same across all of the plan's DIAs and benchmarks, to ensure that the chart provides "comparability" among all of the plan's DIAs. Q-23.

- DOL made clear that if there is a change to the fee and expense information for a plan's DIA after the plan administrator has issued a comparative chart, there is generally no requirement to issue an updated chart or disclosure before the next annual disclosure is provided. Nonetheless, DOL made clear that it would expect the DIA's fee and expense information on the plan's website to be updated and kept reasonably current throughout the year. Q-22.

- DOL clarified how to calculate the total annual operating expenses of a DIA that is a fund of funds, meaning a fund that invests its assets at least in part in other pooled investment funds. DOL clarified that, in the case of a fund of funds DIA that is a registered investment company, the total annual operating expenses calculation should follow the guidance in SEC Form N-1A that requires "acquired fund" fees to be reflected in the operating expenses of the "acquiring fund." See Instruction 3(f) to Item 3 of SEC Form N-1A (providing a specific methodology for calculating fund operating expenses in the case of "acquired funds"). Moreover, DOL made clear that it intends to achieve as much symmetry as possible between total annual operating expenses calculations for registered and unregistered DIAs. Therefore, the calculation of total annual operating expenses for an unregistered DIA fund of funds should follow the same principles as articulated for registered investment companies under the SEC's Form N-1A. Q-31.

5. Open Brokerage Window Disclosures

- Regarding open brokerage windows, DOL confirmed that commissions or fees charged in connection with the purchase or sale of securities through the window (such as per-trade fees), including front end sales loads, generally would have to be disclosed if they are known at the time of the disclosure. *See* 29 C.F.R. § 2550.404a-5(c)(3)(i)(A). However, DOL recognized that in many cases, the front end sales loads or other commissions charged in connection with the purchase of specific securities may not be known at the time the disclosure is made. Accordingly, DOL clarified that the requirement to disclose these fees would be met as long as the plan's disclosure directs participants as to where they may find additional information about such fees. The DOL further made clear that quarterly participant statements must disclose actual dollar amounts charged against a participant's account in connection with brokerage window transactions, including front end sales loads and trading commissions. *See* 29 C.F.R. § 2550.404a-5(c)(3)(ii)(A). Q-13.

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6. Other FAQs

- DOL confirmed that the participant disclosures are not required for certain 403(b) annuity and custodial accounts issued before January 1, 2009 that were excepted from the 408(b)(2) regulation under DOL's recently finalized 408(b)(2) Regulation. *See* 29 C.F.R. § 2550.408b-2(c)(1)(ii). Q-2

- DOL confirmed that a "designated investment manager," a term not defined under the regulation itself, is a section 3(38) manager designated by the plan's fiduciary and made available to participants to manage their plan account balances. The term does not include a 3(38) manager who manages one of the plan's investment options (such as a separately managed account or other investment fund) and who does not manage the investment of participant accounts. Q-4.

We hope this summary is helpful. Please let us know if you have further questions or concerns involving these rules.