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SUMMARY OF DOL FINAL PARTICIPANT-LEVEL DEFINED CONTRIBUTION PLAN FEE DISCLOSURE REGULATIONS

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On October 15, 2010, the Department of Labor (“DOL”) released long-awaited final regulations which impose fiduciary disclosure requirements on plan administrators for ERISA-covered individual account plans that permit participant investment direction. The final regulations are applicable for plan years beginning on or after November 1, 2011.

Covered Plans and Participants

The final regulations apply to all participant-directed individual account plans subject to ERISA, not just those that have elected to comply with ERISA section 404(c). Individual account plans that do not permit participant investment direction are not covered by the regulations. Employment-based IRAs subject to ERISA, such as SEPs and SIMPLEs, are also exempt.

The disclosures are required with respect to any participant or beneficiary who has the right to direct the investment of his or her account. The preamble notes, however, that the term “participant” is broadly defined to include any employee who is eligible to participate, for example, to make elective deferrals to a participant-directed 401(k) plan, even if that employee has not enrolled in the plan. Thus, disclosures may need to be provided to some individuals who do not have accounts in the plan.

Plan-Related and Investment-Related Information

There are two broad categories of information that must be disclosed – plan-related information and investment-related information.

Plan-Related Information. Plan administrators must disclose: (i) general information regarding investment direction (e.g., how participants and beneficiaries may give investment instructions); (ii) information about plan-level administrative expenses

charged against participant accounts (*e.g.*, annual per-participant fees); and (iii) information about expenses that may be charged individually to accounts (*e.g.*, loan initiation fees, fees for brokerage windows, redemption fees).

Investment-Related Information. For each designated investment alternative, plan fiduciaries generally must provide: (i) identifying information including the type or category of the investment (*e.g.*, large cap fund); (ii) performance data; (iii) comparison of returns to a benchmark; (iv) fee and expense information for each designated investment alternative, discussed below; (v) an internet website address with additional information; and (vi) a general glossary of investment terms (which may be provided through the internet website).

A requirement in the proposed regulations to disclose the type of management utilized by the investment (*e.g.*, passive or active) was not included in the final regulations.

Performance data means the average annual total return of the investment for the 1-, 5-, and 10-calendar year periods. For the next 10 years, a special rule applies to non-mutual fund investments, such as collective investment trusts, if the plan administrator reasonably and in good faith determines that it does not have the information on expenses necessary to calculate historic rates of return. The special rule allows use of a reasonable estimate of fees in calculating historic rates of return.

The final rule retains the requirement that a benchmark be included for each investment. The benchmark must be a broad-based securities index. The final regulations, however, allow the use of a blended benchmark for investments that include both equity and fixed income exposure, provided the blend reflects the blend of equity and fixed income in the investment fund. Query how this will work in the typical case where a fund's blend varies over time.

The fee and expense information includes: (i) the amount and a description of each shareholder-type fee charged directly against a participant's or beneficiary's investment (*e.g.*, sales loads, surrender charges); (ii) the total annual operating expenses of the investment expressed as a percentage (*e.g.*, expense ratio); (iii) the total annual operating expenses for a one-year period expressed as dollar amount for a \$1,000 investment; (iv) a statement indicating that fees and expenses are only one of several factors that participants and beneficiaries should consider when making investment decisions; and (v) a statement that cumulative fees and expenses can substantially reduce the growth of the participant's retirement account. The statement regarding the effect that fees and expenses may have is new to the final regulations.

The final regulations include a methodology for determining the total annual operating expense for a fund that is not a mutual fund, thereby creating a standardized method of calculation and disclosure for non-mutual fund investments.

Special rules apply to investments with a fixed rate of return. In lieu of the performance data described above, the plan administrator must provide the fixed or stated annual rate of return and the term of the investment as well as the extent to which the issuer reserves the right to change the rate of return prospectively. The benchmarking requirement does not apply to funds with a fixed rate of return. In lieu of fee and expense information, the plan administrator must provide the amount and a description of shareholder-type fees, and a description of any restriction or limitation that may be applicable to a purchase or sale of an investment with a fixed rate of return.

Stable value and money market funds are not considered investments that provide a fixed rate of return and, therefore, are subject to the rules discussed above for variable investments. GICs and insurance company general account investments are investments with a fixed rate of return.

Website Information

The final regulations require that certain information be made available for each designated investment alternative through an internet website. In general, the website information provides a more comprehensive view of each investment alternative and includes, for example, information about the alternative's portfolio turnover rate and the alternative's principal strategies and principal risks. The website information must also be available in a paper form. The regulations provide that the website address must be "sufficiently specific" to provide access to the requisite information.

Comparative Chart

Investment-related information must be set forth in the form of a comparative chart. The final regulations provide a safe harbor comparative chart for this purpose. The chart has two parts – one with performance-related information; the other with fee-related information. The performance-related information includes historic performance data and investment benchmarks for each of the plan's investment alternatives. The fee information includes the total annual operating expenses for each investment alternative as well as a narrative disclosure of any shareholder-type expenses. The safe harbor chart lists investments with a fixed rate of return separately from investments without a fixed rate of return. It also lists information about annuities separately.

Form of Disclosure

Fees and expenses may be expressed in terms of a hard dollar, formula, percentage of assets or per capita charge. The only exception is a requirement to provide an

illustrative example for each designated investment alternative of the hard dollar cost of a \$1,000 investment in the fund.

Revenue Sharing Disclosure

The proposed regulations did not require a disclosure informing participants that investment expenses may pay for certain plan services. The final regulations also do not require specific disclosures related to revenue sharing. However, if applicable, the plan administrator must provide a statement indicating 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.

Unbundling of Fees for Services Not Required

The preamble to the regulations states that DOL does not believe it is necessary or useful for participants to have administrative charges broken out and listed on a service-by-service basis.

Brokerage Windows Excluded from Coverage

The disclosure rules do not apply to "brokerage windows," "self-directed brokerage accounts," or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by the plan. However, a plan must disclose the costs associated with utilizing an open brokerage window.

This brokerage window exception may not apply to, for example, mutual fund supermarkets, where hundreds of funds are available, but many investments are screened out. If the exception does not apply and electronic delivery is not realistically available, compliance with the regulations could be very challenging in these cases.

Target Date Funds

The final regulations do not include special rules for target date funds but reserve a section for such rules. The preamble notes that DOL expects to publish a separate notice of proposed rulemaking for such funds. Pending proposed regulations on qualified default investment alternatives are expected to focus on target date funds, and it is possible that these regulations will represent the contemplated proposed rulemaking. Query if there will be a delayed effective date for target date funds in light of the delayed issuance of guidance.

Annuities

The final regulations include special rules for annuities. In general, deferred fixed annuities appear to be treated as investments with a fixed rate of return. However, deferred annuities that provide for the current purchase of a stream of retirement income payments are not subject to the requirements to provide investment-related information. Instead, the plan administrator must provide the following: (i) name of the option; (ii) the option's goals or objectives; (iii) factors that determine the price; (iv) any limitations, or fees or charges, applicable to withdrawals or transfers; (v) any fees that reduce amounts allocated to the option; (vi) a statement that guarantees of an insurance company are subject to its long-term financial strength; and (vii) an internet website address that provides the same information above.

For deferred variable annuities, the final regulations contemplate disclosure of investment-related information for the underlying separate account investments, *i.e.*, performance information and expense information. In addition, the regulations contemplate separate disclosure of other benefits, for example, a guaranteed lifetime withdrawal benefit option. The separate disclosure requirements track the disclosures above for deferred fixed annuities that involve the current purchase of a retirement income stream.

Company Stock

Many of the requirements in the final regulations do not apply to company stock funds. For example, a company stock fund does not need to provide its principal strategies and risks (but instead must provide an explanation of the importance of diversification), the fund does not need to make its portfolio turnover rate available, and the fund does not need to disclose total annual operating expenses or average annual total return.

Time and Manner of Disclosure

The final regulations generally provide that the disclosures must be made on or before the date on which the participant or beneficiary can first direct his or her investments, and at least annually thereafter.

A special rule requires quarterly disclosure of any plan-level administrative fees that were imposed during the immediately preceding quarter and any participant-initiated fees that were imposed in the immediately preceding quarter. The final regulations clarify that this requirement may be satisfied through a confirmation or through inclusion on the quarterly benefit statement.

Updating

The final regulations require updating of any plan-related information that changes within at least 30 days, but not more than 90 days, of the effective date of the change, unless the administrator is unable to provide advance notice due to events that were unforeseeable or circumstances beyond the control of the plan. There is no materiality standard so that all changes are subject to the advance notice requirement.

The updating requirement, however, does not apply to investment-related information. For example, the administrator need not notify participants of mid-year changes in investment fees. These changes must, however, be reflected in the annual notice. DOL has also indicated that website information should be updated as soon as reasonably possible following a change.

Additional Investment-Related Disclosure Upon Participant Request

Certain other information must be provided upon request, including prospectuses, financial statements or reports, statements of share value, and a list of the assets comprising the portfolio of each designated investment alternative that has plan asset look-through treatment (generally, non-mutual funds).

Electronic Media

The final regulations apply the general rules applicable under Title I of ERISA to the use of electronic media to provide disclosures. These rules generally require participant consent to electronic media unless the participant has the effective ability to access the electronic media at work and uses the electronic information system (*e.g.*, a computer) as an integral part of his or her work. Thus, the regulations do not readily facilitate paperless delivery of the required disclosures. The preamble to the final regulations, however, notes that DOL will request comments on the issue and that DOL plans to issue guidance on electronic delivery prior to the applicability date of the final participant fee disclosure regulations. Note that DOL has provided relief for quarterly benefit statements, and it is not entirely clear whether the disclosure requirements that may be satisfied through the quarterly benefit statements will be covered by this relief.

Relief for Reliance on Information Provided by Service Providers

The final regulations state that plan fiduciaries will not be liable for reasonable and good faith reliance on information furnished by their service providers with respect to the information required to be disclosed automatically.

Scope and Penalties

It is not entirely clear whether the final regulations create a mandatory or safe harbor disclosure regime. The regulations take the position that there is a general duty to disclose plan-related and investment-related information to participants and beneficiaries. It then states that plan administrators must make the disclosures required under the regulations. However, one might reasonably argue, for example, that a failure to satisfy all of the technical requirements of the regulations should not result in a breach of fiduciary responsibility.

Unlike legislative proposals or other disclosure requirements in ERISA, which impose specific dollar penalties for a failure to provide the requisite disclosures, the final regulations do not include any specific penalties. Rather, at most, a failure to provide the required information would appear to be a breach of fiduciary duty, which could give rise to equitable remedies in appropriate circumstances.

Effect on Prior Periods

As reflected above, the final regulations reflect DOL's view that plan administrators have a general fiduciary obligation to disclose information about plan investments and fees to participants and beneficiaries. The regulation is silent on years prior to the effective date of the regulations. However, the preamble to the final regulations notes that plans which satisfied the disclosure requirements of section 404(c) of ERISA typically will have satisfied their disclosure requirements for periods before the applicability date of the new regulations. DOL "expresses no view" with respect to other plans.

Treatment of Existing Participants

Notwithstanding that the initial disclosure is generally due before a participant first exercises investment control, a special rule applies to individuals who are participants in covered plans on the date the regulations become applicable. It provides that existing participants must receive the requisite disclosures no later than 60 days after the applicability date. Thus, it appears that a plan administrator cannot wait until it would otherwise send out the annual notice to satisfy its obligations with respect to existing participants.

As mentioned above, the regulations were issued as final regulations and DOL did not request comments.