

Department of Labor Issues New Rules on 401(k) Fee Disclosure to Participants

November 5, 2010

The U.S. Department of Labor recently issued final regulations requiring enhanced fee disclosure to participants in 401(k) plans and other defined contribution plans subject to the Employee Retirement Income Security Act (ERISA) that have participant-directed investments. For purposes of the new regulations, “participant” means any employee who is eligible to participate in the plan, regardless of whether such individual is actually enrolled in the plan.

Disclosure of the new required information will require significant effort from plan administrators and plan service providers.

On October 14, 2010, the U.S. Department of Labor (DOL) issued final regulations requiring enhanced fee disclosure to participants in 401(k) plans and other defined contribution plans subject to the Employee Retirement Income Security Act (ERISA) that have participant-directed investments. These final regulations replace the proposed regulations issued on July 23, 2008. The DOL has been concerned that participants do not have the information they need to make informed decisions on investing their plan accounts, and intends for these new requirements to provide participants with the necessary information to make informed investment decisions.

Background

The new regulations are effective on January 1, 2012, for plans with a calendar year plan year; for non-calendar year plans, the rules are effective for plan years beginning on and after November 1, 2011. The new rules apply to all 401(k) plans and other participant-directed individual account plans subject to ERISA, except for IRAs, simplified employee pensions (SEPs) and simple retirement accounts (SIMPLEs). Disclosure of the new information will require significant effort from plan administrators and plan service providers.

The new regulations require disclosure of two major categories of information: “plan-related information” and “investment-related information.” Some of these mandatory disclosures were previously included in the ERISA 404(c) regulations, but compliance with the ERISA 404(c) regulations is voluntary, and therefore did not cover all participant-directed individual account plans.

Required Disclosures

Under the new regulations, the plan administrator has the fiduciary responsibility to disclose both “plan-related information” and “investment-related information.” The plan administrator may delegate these disclosure obligations to its service providers, but the plan administrator will retain ultimate responsibility for complying with the new disclosure rules. Each of these categories has unique disclosure requirements.

Plan-related information

The new regulations specify three primary types of plan-related information: general information, administrative expenses and individual expenses. General information includes the following:

- An explanation of the circumstances under which participants may give investment instructions
- Identification of the investment options under the plan (for purposes of this article, the term “investment option” does not include self-directed brokerage accounts; special rules applicable to self-directed brokerage accounts are explained in more detail below)
- An explanation of any specified limitations on the participant’s investment rights under the plan, including any restrictions on transfers to or from an investment option
- A description of any voting, tender or similar rights associated with investment options under the plan (or a reference to the relevant plan provisions)
- Identification of any designated investment managers
- A description of any self-directed brokerage accounts available under the plan

Administrative expense information includes an explanation of any fees and expenses for general plan administrative services (such as legal, accounting and recordkeeping services) that may be charged against the individual accounts of participants, but are not reflected in the total annual operating expenses of the plan’s investment options. The plan administrator also must describe whether these fees will be allocated on a pro rata or per capita basis (or other basis, if applicable).

Individual expense information includes an explanation of any fees or charges that may be charged against a participant’s individual account on an individual (as opposed to a plan-wide) basis. These individual expense fees may include fees for processing plan loans or qualified domestic relations orders, fees for investment advice, fees for brokerage windows, front- or back-end loads or sales-charges, redemption fees, transfer fees and optional rider charges in annuity contracts.

Investment-related information

The new regulations use the term “investment-related information” to cover a multitude of items, including the following:

- Identifying information about the investment options, including the name and type of each investment option
- For investment options without a fixed rate of return, the average annual rate of total return of the investment option, as well as a benchmark index, for 1-, 5- and 10-calendar year periods (or the life of the investment option, if shorter); the plan administrator must also include a statement indicating that an investment option’s “past performance is not necessarily an indication of how the investment will perform in the future;” further, the benchmark index cannot be administered by an affiliate of the investment issuer, its investment adviser or a principal underwriter, unless the benchmark index is “widely recognized and used”
- Fee and expense information, including (i) the amount and description of any shareholder fees charged directly against the participant’s account, including commissions, sales loads, sales charges, deferred sales charges, redemption fees, surrender charges, exchange fees, account fees or purchase fees not included in the total annual expense of any investment option; (ii) a description of any restriction or limitation applicable to purchases, transfers or withdrawals to and from an investment option, including round trip, equity wash and other restrictions; (iii) the expense ratio for each investment option expressed as both a percentage and a 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 indicating 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 website for an example demonstrating the long-term effect of fees and expenses”
- A website providing access to the following information for each investment option offered under the plan: (i) the name of the issuer; (ii) the investment objectives and goals; (iii) principal strategies and risks; (iv) the turnover rate; (v) the average annual rate of total return for 1-, 5- and 10-calendar year periods (or the life of the investment option, if shorter), generally required to be updated at least quarterly; and (vi) the same fee and expense information described above (many of these disclosures must be made in a manner that also complies with disclosure rules issued by the U.S. Securities and Exchange Commission; participants must also be able to request paper copies of the information available on the website, free of charge)
- A glossary of investment and financial terms (or a website providing access to such glossary)

- Customized disclosure rules for employer stock funds, generally modifying the standard disclosure rules for the (i) required website information; (ii) expense ratio (expressed as both a percentage and a dollar amount for a \$1,000 investment); and (iii) performance data for 1-, 5- and 10-calendar year periods (or the life of the investment option, if shorter)
- Special disclosure rules for (i) investment options that allow participants to allocate contributions toward the future purchase of an annuity income stream guaranteed by an insurance company; and (ii) fixed-return investments

Most important, the final regulations require the plan administrator to disclose this investment-related information in a chart (or other comparative format), allowing participants to compare the investment-related information for each investment option offered under the plan. The final regulations include a model comparison chart; use of the model chart will ensure compliance with the comparative disclosure requirements.

Timing of Disclosures

The plan administrator must provide a participant with both plan-related and investment-related information (including the comparison chart) on or before the date the participant can first direct his investments under the plan. However, the first disclosure is not required until 60 days following the effective date of the regulations. Therefore, calendar year plans have until March 1, 2012, to provide the initial disclosure.

Thereafter the plan administrator must provide the participant with the required disclosures at least annually. Any changes to plan-related information must be communicated to participants at least 30 days (but no more than 90 days) before the effective date of the change. If the plan administrator is not aware of the change 30 days before the effective date of the change, the notice must be provided as soon as reasonably practicable. There is no materiality standard for this additional notification requirement and any changes to previously disclosed information are subject to this requirement.

With respect to administrative expense information and individual expense information, the plan administrator must provide participants with a quarterly statement that includes the dollar amount of fees and expenses charged against the participant's account during the preceding quarter and a description of the services to which the charges relate. With respect to administrative expenses, the DOL is not requiring the plan administrator to break out the administrative charges in "service-by-service detail" on the quarterly statement; an "aggregate" disclosure of administrative expenses is permissible. In addition, if some of the plan's administrative expenses during the preceding quarter were paid from the total annual operating expenses of one or more of the plan's investment options (such as through revenue sharing arrangements, Rule 12b-1 fees or sub-transfer agent fees), the quarterly statement must disclose this fact.

For purposes of these new regulations, “participant” means any employee who is eligible to participate in the plan, regardless of whether such individual is actually enrolled in the plan. Therefore, initial and annual disclosures are required to both individuals with an account balance under the plan (including any beneficiaries and alternate payees), as well as those eligible individuals not yet enrolled in the plan. However, this expanded definition of “participant” does not apply to quarterly disclosures because those statements are only required with respect to fees actually incurred.

Initial and annual disclosures may be provided with the plan’s summary plan description or quarterly account statements, assuming the plan administrator otherwise complies with the timing requirements set forth under the new regulations. The quarterly disclosures of administrative expense information and individual expense information may also be provided with the plan’s quarterly account statements. These disclosures may be provided electronically in accordance with the DOL’s electronic distribution rules for participant communications. However, the DOL will be soliciting comments on its current electronic distribution rules in the near future and expects to issue revised rules prior to the effective date of the new fee disclosure regulations.

Finally, the plan administrator will not be liable for the completeness and accuracy of such disclosures so long as the plan administrator “reasonably and in good faith” relied on the information provided by the plan’s service provider or issuer of an investment option.

Steps for Plan Administrators

Implementation of these disclosure rules will require significant effort from plan administrators and plan service providers. Plan administrators should familiarize themselves with these new disclosure regulations and start working with service providers and investment issuers to ensure a smooth transition.

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