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PARTICIPANT DISCLOSURE REGULATIONS

The Department of Labor (DOL) has issued a series of regulations that will affect qualified retirement plans beginning in 2012. Many of the changes are only applicable to defined contribution plans (like profit sharing plans and 401(k) plans) where participants are allowed to direct their investments. Other regulations affect all qualified retirement plans. Your investment advisor or third party administrator may have already spoken to you about these changes. If not, you may wish to contact them concerning the information they must disclose to you and what you must disclose to your plan participants.

This is the first of three articles describing these new regulations and will cover the new participant disclosure requirements applicable to "participant directed" defined contribution plans.

1. What is the Deadline for Disclosure?

May 31, 2012 is the deadline for ***initial annual*** disclosures for a calendar year plan and for a non-calendar year plan with a 2012 plan year beginning on or before April 1, 2012. For plans with a 2012 plan year beginning after April 1, 2012, the deadline is 60 days after the first day of the 2012 plan year.

August 14, 2012 is the deadline for the first ***quarterly*** disclosures for a calendar year plan and for a non-calendar year plan with a 2012 plan year beginning on or before April 1, 2012. For plans with a plan year beginning after April 1, 2012, the deadline is 45 days after the end of the quarter in which the plan's initial annual disclosures are due.

There is the possibility that these deadlines may be extended especially if the deadlines for service provider disclosures (described in the second article of this series) are extended.

2. Which Retirement Plans are Covered?

The regulations apply to all participant directed qualified defined contribution plans except SEPs and SIMPLEs. The regulations, therefore, cover all participant directed 401(k) plans, profit sharing plans and money purchase pension plans. It also includes 403(b) plans that are subject to the Employee Retirement Income Security Act of 1974 (ERISA).

Exempted from the regulations are defined benefit plans and welfare plans. Also exempted are plans not covered by ERISA, such as church and governmental plans as well as certain plans that cover only owners.

Plans that offer brokerage windows as their sole investment option will only have limited disclosure obligations since brokerage windows are not considered designated investment alternatives as described below.

3. Who Must Receive the Disclosures?

The disclosures apply to all participants eligible for the plan and any participant who has an account balance. The disclosures, therefore, must be provided to participants eligible for a 401(k) plan even if they choose not to defer, as well as former employees who have not taken a distribution from the plan. The disclosures also apply to beneficiaries who still have account balances to the extent that they can direct the investment in those accounts.

4. Who Must Provide the Disclosures?

The plan administrator (or someone appointed by the plan administrator) is responsible for providing the applicable participant disclosures. With many plans, the employer/plan sponsor is also the plan administrator. In other instances, the employer names a certain individual or a committee as the plan administrator. The name of your plan administrator should be in your summary plan description (SPD). In making the disclosures, however, plan administrators may rely on information received from investment or other service providers.

5. What General Categories of Information Must be Disclosed?

There are "plan-related" disclosures and "investment-related" disclosures. There are three different types of plan-related disclosures: 1) annual operational disclosures, 2) annual and quarterly administrative expense disclosures, and 3) annual and quarterly individual administrative expense disclosures.

6. What are the Content Requirements for Plan-Related Operational Disclosures?

Annually, the plan administrator must provide participants the following information:

- An explanation of the circumstances under which participants may give investment instructions.
- An explanation of any limitations on these instructions.
- Identification of any designated investment alternatives offered under the plan. A designated investment alternative means any investment alternative designated by the plan (other than a self-directed brokerage account/window) into which participants may direct the investment of the plan assets held in their accounts.
- A description of plan provisions regarding exercise of voting rights related to any designated investment alternative (as well as any restrictions on such rights).
- Identification of any designated investment managers.
- A description of any "self-directed brokerage accounts/windows" (or similar arrangement).

7. What are the Content Requirements for Plan-Related Administrative Expense Disclosures?

Annually, the plan administrator must provide participants with an explanation of any fees and expenses for general plan-wide administrative services (*e.g.*, legal, accounting, recordkeeping) that may be charged against individual accounts and are not reflected in the total annual operating expenses of any investment alternative. This explanation must include the basis on which charges will be allocated (*e.g.*, pro rata, per capita). The explanation applies to expenses that ***may*** be charged to participant accounts under the plan's terms even if they are not currently being charged. In addition, as described below, certain plan-related administrative

expense information must also be provided quarterly. For quarterly disclosure purposes only, the fees can be aggregated (there is no need to breakdown recordkeeping from legal, etc.).

8. What are the Content Requirements of Plan-Related Individual Expense Disclosures?

Annually the plan administrator must provide an explanation of any fees and expenses that may be charged to a participant or beneficiary on an individual, rather than on a plan-wide, basis. This would include fees for such things as processing plan loans or qualified domestic relations orders, fees for individual investment advice, fees for brokerage windows, commissions, loads, redemption charges, etc. This includes only those fees that are not reflected in the total annual operating expenses of any investment alternative. These fees cannot be aggregated and ***do*** need to be listed individually. In addition, as described below, individual expense disclosures must be provided quarterly as well.

9. When and How Are Annual Plan-Related Disclosures Made?

The deadline for initial annual disclosures is contained in Q&A1 above. Then, going forward, annual disclosures should be provided on or before the date a participant or beneficiary can first direct his or her investments and at least annually thereafter. Except in exceptional circumstances, if there is a change to any annual plan-related disclosure, then a description of the change must be provided at least 30 days, but not more than 90 days, in advance of the effective date of such change. The annual disclosures can be made in a benefits statement, in a SPD, or in a totally separate document. Of course, if disclosures are made in the SPD, care must be taken to redistribute the SPD annually.

10. When and How are Quarterly Plan-Related Disclosures Made?

The deadline for the initial quarterly disclosures is contained in Q&A1 above. The quarterly requirement applies to plan-related administrative expense and individual expense information and must contain the dollar amount of the expenses and a description of the services to which the charges relate. As mentioned above, plan-wide administrative expense charges can be aggregated into one charge while individual administrative expense information cannot. If some of the plan's expenses were paid from the total annual operating expenses of one or more

of the plan's designated investment alternatives (*e.g.*, through revenue sharing arrangements) there must be a disclosure of this arrangement but details of the revenue sharing payments are **not** required to be disclosed.

These disclosures can be made separately or made part of the quarterly benefits statement**.**

11. What are the Investment-Related Disclosure Requirements?

There are separate disclosures required for each "designated investment alternative" in a plan. A designated investment alternative (DIA) is defined as any investment alternative designated by the plan (other than a self-directed brokerage account) into which participants may direct the investment of the plan assets held in their accounts. The following is the information which must be disclosed for each DIA:

- *Identifying Information.* The name of the DIA and the type or category of the investment (*e.g.*, money market fund, balanced fund (stocks and bonds), large-cap stock fund, etc.).
- *Performance Data.*
  - If the return is not fixed then the average annual total return of the DIA for 1-, 5-, and 10-calendar year periods (or for the life of the DIA, if shorter) as well as a statement indicating that a DIA's past performance is not necessarily an indication of how the investment will perform in the future.
  - If the return is fixed then the fixed rate as well as a statement (if applicable) that the DIA issuer reserves the right to choose the fixed rate of return. If the rate of return can be changed then the current rate of return and any minimum guaranteed rate must be provided as well as how to obtain (*e.g.*, by telephone or website) the most recent rate of return.
- *Benchmarks.* If the return is not fixed the name and returns of an appropriate broad-based market index over the 1-, 5-, and 10-calendar year periods.

- *Fee and Expense Information (if the return is not fixed).*
  - The amount and a description of each shareholder-type fee that is not part of the expense ratio of the DIA. In other words, fees charged directly against a participant's or beneficiary's investment, such as commissions, sales loads, sales charges, deferred sales charges, redemption fees, surrender charges, etc. as well as 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 (such as round trip, equity wash, or other restrictions).
  - The total annual operating expenses of the DIA expressed as a percentage (i.e., expense ratio).
  - The total annual operating expenses of the DIA for a one-year period expressed as a dollar amount for a $1,000 investment.
  - A statement indicating that fees and expenses are only one of several factors that should be considered in making plan investments.
  - A statement that the cumulative effect of fees and expenses can substantially reduce the growth of a retirement account and that participants and beneficiaries can visit the Department of Labor EBSA website for an example demonstrating the long-term effect of fees and expenses.
- *Fee and Expense Information (fixed return).* 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.
- *Website Address.* An internet website address that provides for each DIA the following: the name of the issuer; objectives or goals; principal strategies (including a general description of the types of assets held by the investment) and principal risks; portfolio turnover rate; performance data; and fee and expense information.
- *Glossary.* A glossary of terms (or a link to a website that can provide the glossary).
- *Annuity Options.* For each annuity option, the name of the contract or product; objectives or goals (*e.g.*, to provide a stream of fixed retirement income payments for life); the benefits and factors that determine the price (*e.g.*, age, interest rates, form of distribution); any limitations on the ability to withdraw or transfer amounts allocated to the annuity (*e.g.*, lock-ups) and any fees or charges applicable to withdrawals or transfers; any fees that will reduce the value of amounts

under the annuity (*e.g.*, 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 link to a website that provides further information.

- *Employer Securities.* There are special disclosure rules for employer securities (company stock) where certain disclosure requirements are eliminated and others are added (such as a reference to the importance of a well balanced and diversified investment portfolio).

12. When and How are Annual Investment-Related Disclosures Made?

The deadline for the initial annual investment-related disclosure is contained in Q&A1 above. Thereafter, the disclosures must be provided on or before the date on which a participant can first direct his or her investments and at least annually thereafter. The information must be provided in a comparative format or chart. DOL has provided a model comparative chart that can be used.

13. Are There Other Investment-Related Disclosure Obligations if a Participant Requests More Information?

The following investment related information must be provided if a participant makes a request:

- Any prospectuses (or, alternatively, any short-form or summary prospectus).
- Financial statements or reports.
- The value of a share or unit of each DIA as well as the date of the valuation.
- A list of the assets comprising the portfolio of each DIA which contains plan assets (under the ERISA plan asset rules).

14. How do the Participant Disclosure Regulations Interact with ERISA Section 404(c)?

ERISA Section 404(c) contains a set of optional disclosures that allows ERISA plan fiduciaries to transfer liability for certain investment decision-making to the participants in the plan. For example, if Section 404(c) is followed, a plan fiduciary should be protected from liability in a suit by a plan participant who lost money based on his or her choice of an international stock fund over a money market fund. The extent of Section 404(c) protection is

currently a matter of some dispute and is beyond the scope of this article. Some plan sponsors, however, chose not to even attempt to comply with Section 404(c) because of the disclosure obligations.

The new participant disclosure regulations are applicable to participant directed defined contribution plans whether they choose to comply with Section 404(c) or not. The only additional disclosure required of a Section 404(c) plan is a notice that the plan intends to comply with Section 404(c) and notice of certain procedures for maintaining the confidentiality of investments in employer securities. Employers who avoided seeking the protection of Section 404(c) status due to the disclosure requirements may now want to reconsider because they will be forced to comply with disclosures as a general matter of prudence.

15. What is the Penalty for Failing to Comply with Participant Disclosure?

A plan administrator who does not comply with the new participant disclosure regulations will be deemed to have breached his/her fiduciary duty. There is no automatic penalty or fine for non-compliance. Also, as mentioned above, non-compliance would mean that there is no Section 404(c) protection.

If you have any questions concerning these new participant disclosure regulations, please contact Kenneth Johnson at Tuggle, Duggins & Meschan, P.A., 100 N. Greene Street, Suite 600, Greensboro, NC 27401, (336) 271-5264.