



# COMPLIANCE ALERT

## AVOIDING POTENTIAL DISCLOSURE PROBLEMS AND FIDUCIARY ISSUES IN RETIREMENT PLANS THAT OFFER CERTAIN INVESTMENT ALTERNATIVES

December 21, 2010

The Department of Labor's ("DOL") participant disclosure regulations<sup>1</sup> require plan administrators, i.e., generally the plan sponsor,<sup>2</sup> of participant directed retirement plans to provide or make available substantial information about plan investments to participants and beneficiaries.<sup>3</sup> The plan sponsor is required to provide the information for all of the plan's investment options to participants in a single "chart or similar format that is designed to facilitate a comparison of such information for each designated investment alternative available under the plan."<sup>4</sup> The DOL specifically stated that "permitting individual investment issuers, or others, to separately distribute comparative charts" would not satisfy ERISA's requirements.<sup>5</sup> A model comparative chart that can, but is not required to be used, was developed by the DOL and included in the regulations.<sup>6</sup>

**The plan sponsor is required to provide the information for all of the plan's investment options to participants in a single "chart or similar format that is designed to facilitate a comparison of such information for each designated investment alternative available under the plan."**

In order for a plan sponsor to be able to comply with the regulations, the issuers or investment managers of the plan's investment alternatives must provide the information to the plan sponsor or its service providers. Although the compliance date for calendar year plans is January 1, 2012, plan sponsors, record

<sup>1</sup> Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans; Final Rule, 29 CFR 2550, 75 Fed. Reg. 64910 (Oct. 20, 2010).

<sup>2</sup> We refer to the "plan sponsor" herein for simplicity and such references are intended to mean the plan sponsor or employer in its capacity as the "plan administrator" that is obligated to comply with the participant disclosure rules.

<sup>3</sup> The regulations require plan sponsors to disclose a substantial amount of other information to participants and beneficiaries, in addition to the investment related information. This Compliance Alert addresses only the investment related disclosure requirements.

<sup>4</sup> 2550.404a-5(d)(2).

<sup>5</sup> 29 CFR 64922 (Oct. 20, 2010).

<sup>6</sup> Id. at 64942.

keepers, and investment providers should educate themselves now on how the rules will affect them in order to avoid potential compliance problems and fiduciary issues for plan sponsors.

Many investment managers and providers of investment options that are not subject to rules that apply to mutual funds, e.g., bank collective investment funds, non-registered “fund of funds”, separately managed accounts and annuities (“non-registered investments”), may be surprised that they will have to provide,

**Many investment managers and providers of investment options that are not subject to rules that apply to mutual funds, may be surprised that they will have to provide, or make available, to plan sponsors significant new information in order for the plan sponsor to comply with the new disclosure requirements.**

or make available, to plan sponsors significant new information in order for the plan sponsor to comply with the new disclosure requirements. Some non-registered investment providers may not have the necessary information readily available. Developing the information and cost effective methods for providing it to plan sponsors and record keepers could

be complex and time consuming. The remainder of this Compliance Alert summarizes some of the disclosure requirements that affect non-registered investment alternatives, discusses The SPARK Institute’s information sharing initiative, and identifies potential fiduciary issues for plan sponsors that continue to offer funds that cannot provide the information required under the regulations.

## A. Non-Registered Investment Options - Disclosure Requirements

The regulations generally apply to all of the investment funds or options offered in a participant directed plan, including bank collective investment funds, non-registered “fund of funds”, separately managed accounts, annuities and employer securities. Comparable information is generally required for all investment options with certain modifications that take into account the unique nature of certain investment types. Set forth below is a summary of the general disclosure requirements and the fund type exceptions.<sup>7</sup>

### 1. General Disclosure Requirements

- a. Name and Fund Type or Category – Identify the fund by name and by type or category, e.g., money market fund, large-cap stock fund, and employer securities.

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<sup>7</sup> The regulations also require non-investment-specific information to be disclosed that is not specifically discussed in this Compliance Alert, e.g., statements about general risks of investing and the date that information is provided. Anyone responsible for making disclosures or providing required information is urged to review the regulations carefully to determine how they apply in their specific situation.

b. Performance Data – The average annual total return for one, five and ten calendar year periods (or for the life of the investment alternative, if shorter) ending on the date of the most recently completed calendar year.

c. Benchmark Data – The name and returns of an appropriate broad-based securities market index for one, five and ten calendar year periods.

d. Fees and Expenses – (i) The expense ratio or total annual operating expenses of the fund expressed as a percentage;

the total annual operating expenses of the fund for a one year period expressed as a dollar amount for a \$1,000 investment, based on the expense ratio and assuming no returns; (ii) The amount and description of any shareholder fee which is not included in the expense ratio or annual operating expenses. This includes amounts that are charged directly against participant accounts, e.g., commissions, loads, redemption fees, and account fees; and (iii) A description of any restriction or limitation that may apply to any purchases, transfers and withdrawals, e.g., round trip limits, and equity wash requirements.

e. Additional On-line Information – The following information must be available on-line: (i) Name of the investment issuer; (ii) The investment’s objectives or goals; (iii) The investment’s principal strategies and risks, including a general description of the types of assets held; (iv) The portfolio turnover rate; (v) Performance data that is updated at least quarterly, or more frequently as required by other applicable law; and (vi) Fees and expense information as described above in Section A, 1, d.

**2. Special Rules** – The following is a summary of some of the special rules and exceptions that apply to certain investment alternatives.

a. Target Date Funds – In addition to the information under Section A, 1, on November 30, 2010, the DOL proposed an amendment to the regulations that would also require that the following information be provided.<sup>8</sup>

**According to Bradford Campbell, former head of EBSA and attorney with Schiff Hardin LLP, “plan sponsors are going to want comfort that service providers can assist them in making these disclosures properly due to the fiduciary risk. Many cases in recent ERISA class action fee litigation unsuccessfully asserted a breach of fiduciary duty for failing to disclose certain fee information to workers. These generally failed because courts found that no such duty existed. It does now, so plans should take this issue very seriously.”**

<sup>8</sup> See 75 Fed. Reg. 73987 (Nov. 30, 2010). The DOL has requested comments on the proposed amendment which are due on January 14, 2011. These additional requirements are, therefore, subject to change by the DOL pending finalization of the proposed rule.

- i. Asset Allocation – An explanation of the alternative’s asset allocation, how the asset allocation will change over time, and the point in time when the alternative will reach its most conservative asset allocation.
  - ii. Chart – A chart, table, or other graphical representation that illustrates such change in asset allocation over time and that does not obscure or impede a participant’s or beneficiary’s understanding of the information.
  - iii. Fund Name and Design – If the alternative is named, or described, with reference to a particular date (e.g., a target date), an explanation of the age group for whom the alternative is designed, the relevance of the date, and any assumptions about a participant’s or beneficiary’s contribution and withdrawal intentions on or after such date.
  - iv. Investing Risks – A statement that the participant may lose money, including losses near and following retirement, and that there is no guarantee that the fund will provide adequate retirement income.
- b. Fixed Return Investments
- i. Performance Data – In lieu of the information described in Section A, 1, b and c, the fixed or stated annual rate of return and the term of the investment. Special rules apply if the issuer reserves the right to adjust the fixed or stated rate of return prospectively during the term of the contract or agreement.
  - ii. Benchmarks – Not required.
  - iii. Fees and Expenses – In lieu of the information described under Section A, 1, d, the amount and description of any shareholder-type fees.
  - iv. On-line Information – Information described under Sections A, 1, e, iii (principal strategies and risks) and iv (portfolio turnover rate) are not required.
- c. Annuity Options – The following information must be provided instead of the information described under Section A, 1 above.
- i. Name – The name of the contract, fund or product.
  - ii. Objective – The objective or goal, e.g., to provide a stream of fixed retirement income payments for life.

- iii. Pricing – The benefits and factors that determine the price of the guaranteed income payments, e.g., age, interest rates, form of distribution.
  - iv. Limitations – Any limitations on the ability of a participant or beneficiary to withdraw or transfer amounts allocated to the option (e.g., lock-ups) and any fees or charges applicable to such withdrawals or transfers.
  - v. Fees – Any fees that will reduce the value of amounts allocated by participants or beneficiaries to the option, such as surrender charges, market value adjustments, and administrative fees.
  - vi. Additional On-line Information – The following information must be available on-line: (1) The name of the option’s issuer and of the contract, fund or product; (2) Description of the option’s objectives or goals; (3) Description of the option’s distribution alternatives/guaranteed income payments (e.g., payments for life, payments for a specified term, joint and survivor payments, optional rider payments), including any limitations on the right of a participant or beneficiary to receive such payments; (4) Description of costs and factors taken into account in determining the price of benefits under an option’s distribution alternatives/guaranteed income payments (e.g., age, interest rates, other annuitization assumptions); (5) Description of any limitations on the right of a participant or beneficiary to withdraw or transfer amounts allocated to the option and any fees or charges applicable to a withdrawal or transfer; and (6) Description of any fees that will reduce the value of amounts allocated by participants or beneficiaries to the option (e.g., surrender charges, market value adjustments, administrative fees).<sup>9</sup>
- d. Employer Securities – The following information is not required: (i) Portfolio turnover rate information described under Section A, 1, e, iv; (ii) The additional on-line fees and expenses information described in Sections A, 1, d & e, vi above, unless the participant acquires units rather than shares; and (iii) Certain fees and expense information under Section A, 1, d, i, unless the participant acquires units rather than shares. Additionally, instead of providing the principal strategies information described under Section A, 1, e, iii, an explanation of the importance of a well balanced and diversified portfolio is required. The regulations also provide an alternative definition for determining “average annual total return” for employer securities in certain situations.<sup>10</sup>

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<sup>9</sup> See 2550.404a-5(i)(2).

<sup>10</sup> See 2550.404a-5(i)(1).

## B. Potential Plan Sponsor Compliance and Fiduciary Concerns

The participant disclosure regulations spell out the information that the DOL believes plan sponsors should provide and make available to participants in order to satisfy their fiduciary obligations. The

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regulations anticipate that plan sponsors will work with their record keepers and other service providers in order to comply, however, it is the plan sponsor that is ultimately and legally responsible for compliance.<sup>11</sup> According to Bradford Campbell, former head of EBSA and attorney with Schiff Hardin LLP, “plan sponsors are going to want comfort that service providers can assist them in making these disclosures properly due to the fiduciary risk. Many cases in recent ERISA class action fee litigation

unsuccessfully asserted a breach of fiduciary duty for failing to disclose certain fee information to workers. These generally failed because courts found that no such duty existed. It does now, so plans should take this issue very seriously.”

The information about non-registered investments must be supplied by the investment provider or manager. Plan sponsors face potentially significant fiduciary issues if an investment provider is unable or unwilling to provide the information that the plan needs in order to comply with the rule. Although the regulation states that a plan sponsor can rely on the information provided to it by a third party,<sup>12</sup> one has to question the prudence and soundness of a decision to continue to offer a fund that is unwilling or unable to provide information that the DOL has stated should be provided and made available to plan participants. Consequently, plan sponsors may be put in the position of having to drop an investment option if the investment provider cannot provide the information that is needed.

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<sup>11</sup> 29 CFR 64911.

<sup>12</sup> 2550.404a-5(b)(1).

### C. SPARK Institute Information Sharing Initiative

Leveraging its experience and expertise in developing information sharing standards for 403(b) plans and lifetime income solutions, The SPARK Institute has begun a new initiative to develop data standards for retirement plan record keepers and non-registered investment fund providers to electronically share information with each other and with existing investment information aggregators. This initiative will identify the data that should be shared and the formats and protocol for sharing it. More information about this initiative will be provided at a future date.

### D. Conclusion

The participant disclosure regulations are complex and impose substantial new responsibilities on plan sponsors that will require issuers and investment managers of non-registered investment alternatives to provide additional information that has not previously been provided and may not currently be available. Plan sponsors should ensure that their non-registered investment providers are preparing to provide the information that is needed. Plan sponsors should also consider whether to continue to offer a fund that is unwilling or unable to provide the information that the DOL has stated should be provided and made available to plan participants.

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**THIS COMPLIANCE ALERT IS FOR INFORMATIONAL PURPOSES ONLY AND SHOULD NOT BE CONSTRUED AS LEGAL OR TAX ADVICE. ANYONE RESPONSIBLE FOR MAKING DISCLOSURES OR PROVIDING REQUIRED INFORMATION IS URGED TO REVIEW THE REGULATIONS CAREFULLY AND TO CONSULT WITH LEGAL COUNSEL ABOUT THEIR SPECIFIC ISSUES AND SITUATION.**

## About The SPARK Institute

The SPARK Institute represents the interests of a broad based cross section of retirement plan service providers and investment managers, including record keepers, banks, mutual fund companies, insurance companies, third party administrators, trade clearing firms and benefits consultants. Members include most of the largest firms that provide record keeping services to employer-sponsored retirement plans, ranging from one participant programs to plans that cover tens of thousands of employees. The combined membership services more than 62 million employer-sponsored plan participants.

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