REGULATION

The Participant Disclosure Regulation

Turning "Experts" into Informed Participants

BY STEPHEN M. SAXON

DOL guidance has advanced the methods through which plan participants may receive required disclosures and plan information in a world increasingly dominated by electronic communications.

We live in a world in which Google and the Internet have made people "experts" on almost every topic. A widespread belief exists that, "I am my own best advocate and can do this better, cheaper and quicker than anyone else." As a result, too few people look to real experts, be they doctors, travel agents or investment advisors, to advise and guide them through life's challenges.

While the rise of the participant directed retirement account did not stem from this newfound personal confidence, it has certainly fed into it. During the late '90s and into the middle of the last decade, a rising market made many investors feel like market-beating experts. However, five years after the bankruptcy of Lehman Brothers and the global financial crisis that followed, some participants are waking up to the fact that in order to properly invest their retirement account, they need accurate, reliable and understandable information about their retirement plans and investment alternatives.

Unfortunately, other participants—many with the encouragement of class action plaintiffs' attorneys—are convinced that their losses must be someone else's fault: the result of excessive fees, substandard investment options or improper disclosures. It was this change in attitude, from confidence to apprehension and anger, as much as anything else, that seems to have caused the Department of Labor to issue participant disclosure regulations under ERISA §404(a)(5).

HISTORY LESSON

The DOL has consistently stated that where participants have been given the responsibility to direct the investment of their own accounts, they must also be provided, on a regular and periodic basis, with sufficient information to allow them to make informed decision about the investments in their plan. In 1992, DOL published the final 404(c) plan regulations, which provided plan fiduciaries of participant directed plans with certain protections if they followed a voluntary disclosure regime. The 404(a)(5) regulations—which, unlike the 404(c) regulations, are mandatory—built upon this disclosure regime and describe the information that must be furnished and how often it must be provided in order for participants to be able to make informed decisions.

Much of the 404(a)(5) information was previously available to participants as part of a summary plan document or an investment fund's prospectus. However, the new regulations require the plan administrator, or its designee, to pull together the information that the DOL believes every plan participant needs to know and to put it into a concise and easy-to-understand document that is furnished to every person eligible to participate in a plan at least once every 12 months. The DOL also requires investment-related information to be provided in a chart or other format designed to facilitate a comparison between the investment alternatives. And to further enhance a participant's ability to make comparisons between investments, the DOL also now requires all plan investments to calculate their expense ratios and performance data using a standard methodology.

INFORMATION OVERLOAD

On more than one occasion, I have suggested that participants will be overwhelmed by the amount of information provided to them under the participant disclosure regulation. The list of information that must be furnished is more than a participant could hope to assimilate and digest. It is what we call "information overload." Under the regulation, plan-related information includes the identity of every designated investment alternative and any investment managers offered under a plan, an explanation how a participant may direct the account and any limitations on their ability to provide those directions, a description of a brokerage window if one is offered and an explanation of all of the fees and expenses associated with participating in the plan or investing in a particular investment. Required investment-related information includes, for every designated investment alternative: the fees, including the expense ratio, associated with the investment; 1, 5, and 10-year returns for the investment; a corresponding benchmark return; and a website address with additional information. Certain types of investments, such as annuity contracts and fixed return investments, have their own disclosure requirements.

FEE DISCLOSURE

In a boon to bundled service providers, and a slap to the face of the plaintiffs' bar, the regulation did not require fees to be broken down or to be delineated in any specific format. The DOL went so far as to include a footnote in the regulation's preamble allowing the quarterly disclosure of certain plan administrative expenses to be aggregated, stating

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that a breakdown of those expenses is unnecessary and not particularly useful to participants.

Far more disconcerting to the plaintiffs' bar, the DOL also limited the amount of information that must be disclosed to participants about revenue sharing arrangements between plans, service providers and investment managers. The regulation requires, if applicable, a statement to be provided to participants with an account balance explaining that a portion of one or more of the investment alternatives' expense ratio is used to pay plan expenses. However, the regulation does not require the plan administrator to identify which investment alternatives pay revenue sharing or describe how much revenue sharing is paid or what services it pays for. Class action plaintiff attorneys were obviously hoping the DOL would go much further, arguing that it would be in the interest of participants to disclose all fees on an unbundled basis. Fortunately, the DOL did not accept their argument.

FIDUCIARY DISCLOSURE

Shortly after publishing the 404(a)(5) regulations, DOL released the long-awaited final fiduciary disclosure regulations under section 408(b)(2) of ERISA. This set of regulations requires "covered service providers" to furnish information to plan fiduciaries about their status (i.e., if they are a fiduciary), the services they will render and the compensation they will receive for rendering those services. In this regulation, the DOL took a different approach toward the disclosures required for bundled service contracts and revenue sharing arrangements and required service providers to offer plan fiduciaries detailed descriptions of any revenue sharing arrangements. The regulation also required bundled service providers to provide a description of the compensation or costs associated with the recordkeeping services provided to the plan. The other services may remain bundled.

Fiduciary disclosures are designed to be sent to plan fiduciaries, but it remains an open question whether participants may request these documents as instruments under which the plan is established or operated pursuant to section 104(b)(4) of ERISA. So the plaintiffs' bar might not be so disappointed after all.

It was always assumed that the 408(b)(2) and 404(a)(5) disclosures would work together, and generally it appears that this is the case. This is particularly true for plans that have a limited number of plan service providers. In what seems like a natural next step, plan sponsors appear to be turning to their record keepers and bundled service providers to create and furnish the 404(a)(5) disclosures. Record keepers that refuse to establish

and maintain a 404(a)(5) website and provided the annual disclosures will likely end up losing business to the service providers that are willing to help with providing required disclosures to participants.

FIELD ASSISTANCE BULLETIN 2012-02

In May 2012, to help ease the pain of compliance with the new regulation, the DOL released Field Assistance Bulletin (FAB) 2012-02, a set of frequently asked questions. The FAB became infamous in the ERISA community thanks to Question #30 on brokerage windows, which created a set of new fiduciaries duties for those arrangements.

Thankfully, after intense lobbying and pressure, the DOL modified and replaced Question #30 in a revised FAB released in July 2012. Due to the concern and reaction to Question #30, many of the FAQs receive much less attention than they normally would and should have received.

Among these overlooked FAQs is Question #2, which exempted "frozen" 403(b) plans from the definition of covered plans. This guidance was consistent with two previous DOL Field Assistance Bulletins, 2010-01 and 2009-02, and the definition of "covered plans" in the 408(b)(2) regulation. The exemption was not unexpected; however, without it, a plan sponsor would have been required to provide participants with information that it had little or no ability to obtain.

Another major cause for relief was found in Question #28. Many in the employee benefits community had been concerned that the regulation's definition of "designated investment alternative" was broad enough to include "model portfolios." Model portfolios are tools used by plans to make investing easier for participants by giving them the ability to select a predetermined investment allocation based upon personal characteristics such as age or risk tolerance.

Many, if not most, record keepers do not calculate expense ratios or performance information for model portfolios. Instead, they provide information about the investments that the participant invests in through the model. In Question #28 the DOL stated that it would allow this approach, as long as the model portfolio was properly explained, unless the participant acquired an equity stake in the model portfolio itself.

WHAT'S IN STORE NEXT?

Going forward, the DOL continues to promise a set of FAQs on the 408(b)(2) regulation. Those FAQs will probably also affect how plans will comply with the 404(a)(5) regulation. However, the most interesting and significant change to the 404(a)(5) regulation may occur as part the pension benefit statement regulation which, as of the writing of this article, is being reviewed by the Office of Management and Budget in a "prerule" stage.

The 404(a)(5) regulation requires certain quarterly disclosures. In Technical Release 2011-03R, the DOL said that those statements could still, per FAB 2006-03, be furnished on a continuous access website. Phyllis Borzi, head of the DOL's Employee Benefits Security Administration, has not been shy in making her dislike of that FAB known. Therefore, it would not be surprising if the pension benefit statement regulation limited or revoked the continuous access website rules found in the FAB and replaced them with rules making the electronic disclosure of the quarterly 404(a)(5) information more difficult and less widespread.

With the initial disclosures under 408(b)(2) and 404(a)(5) now completed, it is evident the employee benefits community has had a lot on its plate. While 2013 is shaping up to be a less challenging year, those regulations still leave several questions unanswered. We expect that DOL will attempt to address these issues later in 2013. PC

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Online Tool Decodes Disclosure Regs

Some liken the recent fee disclosure regs and the preparation for them to Y2K—others say it has just been a big waste of paper. Regardless, it's not going away, and fees and transparency are front and center in the minds of employers and participants. The question is: How can participants really calculate how much they are paying in English, and how does that compare?

An online tool, "Personalized Expense Ratio Calculator" (PERC), claims to help plan participants determine their costs within a 401(k) plan. The tool is designed to go beyond the DOL's recent revisions to the 408(b)(2) and 404(a)(5) reporting requirements. Neither regulation calls for the calculation and display of a plan's or a participant's total plan cost. The Personalized Expense Ratio was designed to provide a more precise calculation by including investment expenses and aggregating fees from multiple service providers.

Will participants use this? Will it help them to focus on the real issue, which is that they're probably not saving enough? Or perhaps, like the 408(b)(2) and 404(a)(5) disclosures, the tool will help people to be more aware and engaged with their retirement planning. The tool was introduced late last year by Lincoln Trust.