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The New Retirement Plan

Participant Disclosure Rules

Retirement plan administrators (generally the plan sponsors) will be required under new Department of Labor ("DOL") Regulations to disclose detailed information to participants about plan fees, investment options, and plan features by August 30, 2012. The rules apply to participant-directed, individual account plans (e.g., 401(k) and 403(b) plans) that are covered by the Employee Retirement Income Security Act of 1974 ("ERISA"), as amended. Defined benefit plans, government 457 plans, IRAs, SEPs, and SIMPLE plans are not subject to the rules. Plan administrators can expect substantial assistance from their record keepers and other service providers, but should be mindful of the fact that the new rules make the plan administrator ultimately responsible for compliance. The DOL had postponed the original compliance deadline to give everyone affected more time to prepare and because some of the new rules may still need to be clarified. Complying with the new rules will require some time and effort by plan administrators and, possibly, some decisions. The following is a summary of the new rules, their impact, and potential implications for plan administrators.

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New Obligations for Plan Sponsors and Substantial Information for Participants

Background

The DOL has stated that plan fiduciaries, such as the plan administrator, must take steps to ensure that participants who manage their individual accounts are made aware of their rights and responsibilities with respect to managing their individual accounts. This requires that they be provided with sufficient information regarding the plan, its fees, expenses, and designated investment alternatives to make informed decisions about the management of their accounts. Prior to the issuance of these rules, plan sponsors did not have specific disclosure obligations they had to satisfy. Many plan sponsors already provide substantial information to participants, particularly those whose plans are intended to be "404(c)" plans; that is, were intended to meet the requirements of the DOL's safe-harbor rule (referred to herein in as the "404(c) regulation") relieving plan fiduciaries of certain potential liabilities with respect to participant-directed investment transactions. However, over the last several years, lawmakers, including Congress and others, have became concerned that participants may not have easy or complete access to all of the information that may be needed to manage their accounts and make investment decisions. As a result, the DOL issued the new regulations to establish uniform, basic disclosures for participants.

Disclosure Requirements

Who Must Make Disclosures?

As noted above, the plan administrator, which is often the plan sponsor, is primarily responsible for complying with the new rules by providing disclosures to participants. Plan service providers will play a critical role in developing the systems, documents, and procedures, and in gathering information from investment providers in order to help plan administrators. Moreover plan administrators generally will not be liable for relying reasonably and in good faith on information supplied by a service provider. Plan administrators should be proactive in communicating with their service providers in order to determine how much support the vendor will provide and the residual responsibilities that will have to be handled by the plan administrator.

Who Must Receive the Disclosures?

The disclosures must be provided to all plan participants, eligible nonparticipating employees, beneficiaries who are able to direct a plan account, and individuals with Qualified Domestic Relations Order (QDRO) rights (for simplicity, referred to hereinafter collectively as "participants"). Plan administrators can begin preparing to comply by identifying the eligible nonparticipating employees and other individuals who may not currently be receiving plan materials.

Plan administrators should be proactive in communicating with their service providers in order to determine how much support the vendor will provide and the residual responsibilities that will have to be handled by the plan administrator.

Plan Administrative Expenses

The disclosures must include a description of the plan administrative expenses (e.g., administrative and accounting fees, legal expenses, etc.) that may be charged to or deducted from participant accounts. These are items that are not included in the expenses of the investment options that may be allocated to participant accounts. The disclosure must explain how they will be allocated, using formulas, rates or dollars, as appropriate. This type of explanation was not previously required to be provided by the plan administrator, so it may be new information for many participants. Plan representatives should anticipate recieving some questions about it.

Individual Expenses

The amount of any account charges that may be charged to a participant's individual account, such as loan fees or costs associated with QDROs or brokerage accounts, must be disclosed.

Investment-Related Information

The investment-related disclosures are the centerpiece of the new rules and they require that specific information about all of the investment options in a plan be provided in a comparative chart. The chart is a source of critical investment-option information that will make it easier for participants to get the information and to compare their investment choices. The DOL developed a model comparative chart and will consider a plan administrator that accurately completes the model chart to have met this part of the disclosure requirements. Some of the information that must be provided in the chart for each fund includes the following:

- The fund name and its asset classification (e.g., large cap stock fund).
- Performance returns for 1, 5, and 10 calendar years (or the life of the fund, if shorter) for variable rate of return funds (e.g., equity funds). Fixed rate of return funds must show the rate of return and the term.
- For each investment, the returns of an appropriate broad-based securities market benchmark (e.g., S&P 500 Index) over comparable periods.
- A description and the amount of any shareholder fees that are charged directly against a participant's account (e.g., sales charges).
- The investment's total annual operating expenses that reduce the rate of investment return, expressed as a percentage (e.g., an expense ratio).
- A description of any restrictions on purchases or sales of each investment (e.g.,"round trip" limits).
- The total annual operating expenses for a one-year period, expressed as a dollar amount for each $1,000 invested.

The chart must also include the following additional information:

- An internet web site address providing access to additional information for each investment option, including the fund's investment objectives, strategies, and risks, its portfolio turnover rate, the latest quarterly performance information and related fees and expenses.
- A glossary of terms to assist participants in understanding the investment terminology. The glossary has the potential to be lengthy so the chart can provide a web address to an electronic glossary.
- A statement that fees and expenses are only one factor to consider in making investment decisions.
- A statement that the cumulative effect of fees can substantially reduce retirement savings.

Investment options that are available through a brokerage window do not have to be included on the comparative chart. The DOL recognized that doing so would not be feasible. Special rules apply to fixed-return investments, annuity products, and employer stock. The DOL recently clarified that, although model portfolios are generally not subject to disclosure on the comparative chart, a description of how the model portfolio works and how it differs from the plan's investment options must be included. Plan sponsors should be aware that, in some instances, model portfolios must be considered a designated investment alternative (DIA) under the plan and included on the chart (e.g., where participants receive a unitized value of a fund or a portfolio is not composed of the plan's other DIAs.) The rules are complex and the amount of information that must be gathered and consolidated is significant. Plan administrators are likely to need substantial assistance from sophisticated and well prepared service providers.

Participant Statements Disclosures – Fees and Expenses Actually Paid

In addition to providing participants with explanations about the fees and expenses that may be charged to their accounts and providing the required investment-related information, plan statements must also provide participants with disclosures that show the actual amount of fees and expenses deducted from their accounts (which may be included in quarterly account statements). Any charges deducted directly from a participant's account must be disclosed, along with a description of the services for which the fees were charged. Investment fees and expenses that are embedded in the investment options, i.e., a fund's total operating expenses, do not have to be disclosed in this manner. The disclosure (e.g., quarterly participant statements) must include a general statement, when applicable, that some of the plan's administrative expenses were subsidized from payments out of the total operating expenses of the plan's investment options. This is how the DOL has chosen to require plan administrators to inform participants that some of the costs to operate the plan are paid indirectly by them. Only this general statement is required instead of dollar amounts or rates. The explanations that must be included on statements provide information that was generally not previously required to be provided by the plan administrator. Plan representatives should anticipate getting questions from participants about the new information.

Plan-Related Information

The new rules also require participants to receive specific plan-related disclosures, which include some general information about investment instructions and limitations. These disclosures must include the following:

1. a list of the plan's investment options,
2. an explanation about how participants can direct plan investments,
3. an explanation of any limitations on directing plan investments, such as transfer restrictions,
4. a description of any self directed brokerage features available under the plan,
5. the identity of any designated investment managers, and
6. information about plan provisions on investment – related voting, tender or similar rights.

> **All of the disclosures, except for the individual disclosures that may be included in participant statements as described, must be provided to participants by the day they can first direct investments in their accounts, and then at least annually.**

How Must the Disclosures Be Made?

Except as specifically permitted under current DOL regulations, the participant disclosures generally must be provided in writing, some of which can be included on or with participant statements or in the plan's Summary Plan Description. The DOL regulations provide a Safe Harbor method to deliver participant disclosures electronically. However, since the safe harbor generally requires among other things, an individual's consent to electronic disclosure, the current DOL rules are fairly restrictive on how plan administrators may deliver materials to participants electronically. The DOL recently received many requests to relax its electronic delivery rules. The DOL has said that it is evaluating its policies and is considering issuing additional guidance about electronic communications.

In the meantime, the DOL had issued an interim policy specifically for the electronic delivery of the participant fee disclosures. The interim guidance permits different delivery methods based on the category of information that is being delivered (e.g., plan-related, individual expenses, investment-related). The guidance sets out three electronic disclosure options: (1) the Safe Harbor method that, among other things, generally requires an individual's consent to electronic disclosure; (2) the Continuous Website method currently permitted to deliver quarterly statements; and (3) a new email method. The new email method requires, among other things, that a participant voluntarily provide an email address in response to an initial notice.

Under the interim guidance, the initial notice must generally be provided in paper form, except under limited circumstances. In addtion, while investment information must be provided via the Safe Harbor or Email methods, other parts of the disclosure may only be provided in a Safe Harbor or Continuous Website method. Therefore, it appears that the interim, guidance will be of limited utility in delivering once disclosure containing all of the information required for the initial and subsequent disclosures. We await further DOL guidance in this regard.

Timing of Disclosures

All of the disclosures, except for the individual disclosures that may be included in participant statements, as described above, must be provided to participants by the day they can first direct investments in their accounts, and then at least annually. The participant statement disclosures that provide information about fees and expenses deducted directly from participant accounts must be provided quarterly. Changes to the plan-related and individual expense information that are provided to participants generally must be disclosed between 30 and 90 days in advance of the change. After the initial disclosure, updated investment-related information set out in the chart must be provided annually. Other investment-related materials, such as prospectuses and financial reports, must be provided to participants upon request.

Other Changes and Important Issues

Participant-Directed Plan 404(c) Safe Harbor Changes

The DOL made two helpful changes to the 404(c) regulations. First, it integrated the disclosure requirements under the 404(c) regulations with the new plan participant disclosure rules by removing some disclosure requirements from the 404(c) regulations and simply cross-referencing the new regulations. This means that, generally, the same investment-related information has to be provided to participants under the two regulations. Second, the DOL eliminated the prospectus delivery requirement under the 404(c) regulations. Under the revised rule, participants must only be provided with a copy of a fund prospectus if they ask for it. DOL regulations clarified that 404(c) does not mitigate a plan sponsor's duty to prudently select and monitor the plan's service providers. In a recent Field Assistant Bulletin (FAB), the DOL clarified that this duty includes selecting and monitoring providers of brokerage windows, self-directed brokerage accounts, etc. (broker-dealers) as well.

Potential Unavailability of Certain Investment — Related Information

The new rules generally apply to all types of investment options available in participant-directed plans, including frozen and closed investment options, "non-registered" investment products such as bank collective investment funds, plan-specific "fund of funds," separately managed accounts, and annuities. The goal is to ensure that participants have the same or comparable information available to them for all of the investment options in the plan. Some of the information that will be required has not historically been available from, or even calculated by, certain investment product providers.

For example, some bank collective trusts have not calculated an expense ratio or portfolio turnover rate, or if they have calculated an expense ratio, have not calculated it in the way the new regulations require. However, the information needed in order to comply with the new rules must be calculated and supplied by the investment provider or manager. If an investment product provider is unable or unwilling to do the calculations and provide data on an ongoing and timely basis, responsible plan fiduciaries face potentially difficult fiduciary decisions about whether or not to continue offering the non-compliant funds. Although, as discussed below, the regulations include a good faith compliance exception for plan fiduciaries, the regulations do not state that, when a plan fiduciary knows that the required disclosure information is incomplete or unavailable, it will be protected under this "good faith" exception. The concerns about unavailable information and the implications for plan participants, if an investment option must be removed from a plan, have been pointed out to the DOL but it is not clear whether additional guidance or relief for these situations is forthcoming.

The DOL did clarify in a recent FAB that the total operating expense calculation of a DIA that is a fund of funds and that is also a registerd investment company should follow the guidance in SEC Form N-1A. The DOL seeks to promote consistency in the reporting of total annual operating expenses of a registered and unregistered fund of funds.

Compatibility with SEC Rules

The Securities and Exchange Commission (SEC) regulates advertisements and sales materials given to potential investors, including plan participants. Some industry groups were concerned that the requirements for participant fee disclosures would not be the same as the SEC requirements, potentially requiring different disclosures for some of the same material. In response to this concern, the SEC issued a No-Action Letter indicating that materials that comply with the participant fee disclosure rules will be treated as satisfying the SEC advertising rules.

Good Faith Compliance

The regulations state that a plan administrator will not be liable for its good faith and reasonable reliance on inaccurate or incomplete information provided to them by service providers. However, as noted above, a plan fiduciary who knows that specific information that must be disclosed is not available will most likely find it difficult to rely on this exception. In addition, the DOL recently released a FAB which clarified (and perhaps added to) some of the participant disclosure requirements. The DOL indicated that it would not bring an enforcement action against a plan administrator whose disclosure did not meet the terms of the FAB, if the plan administrator acted in good faith, based on a reasonable interpretation of the regulations, and creates a plan for complying with the FAB in future disclosures.

Effective Date

For calendar year plans, the first disclosures must be made no later than August 30, 2012. However, the deadline for making the first disclosure of actual fees and expenses (usually made in quarterly participant account statements, as described above) is November 14, 2012.

ADP welcomes the enhanced disclosure brought about by the new regulations. We believe that the new regulations benefit plan participants. To support the needs of our clients, ADP will prepare the participant fee disclosure document and work with our clients on how it can be distributed to their employees. For more information contact ADP at ***800-432-401k*** *or visit us on the web at* ***www.adp.com/401k.***

The Participant Disclosure Rules are extensive and include additional rules and requirements that are beyond the scope of this summary. The information provided in this summary is for general educational purposes only. ADP, Inc. and its affiliates do not provide legal, financial, investment or tax advice and nothing herein is intended or should be construed as such. Plan sponsors, plan administrators, and anyone else that may be affected by the rules should consult with their legal counsel and advisers regarding their specific issues and circumstances.

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