Department of Labor Proposes Additional Disclosure Rules for QDIAs and TDFs

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The U.S. Department of Labor recently issued proposed regulations requiring additional disclosures to participants who direct investment in qualified default investment alternatives (QDIAs) and target date funds (TDFs). These proposed disclosure rules will impact participant-directed account plans that default participant money into QDIAs in the absence of affirmative participant investment elections, as well as participant-directed account plans that permit or mandate investment in TDFs. Assuming the final regulations are substantially similar to the proposed regulations, compliance with these additional disclosure rules will require significant effort from plan sponsors, plan fiduciaries and plan administrators.

The U.S. Department of Labor (DOL) issued proposed regulations that require additional disclosures for a participant's investment in qualified default investment alternatives (QDIAs) and target retirement date funds (TDFs). The DOL had two primary reasons for issuing these proposed regulations. First, the DOL provided more guidance and specifics on the content for participant disclosures under existing QDIA regulations. Second, following the 2008 market decline and recent public hearings on TDFs, the DOL believed that participants would benefit from additional disclosures regarding investments in TDFs.

Background

The proposed regulations will be effective 90 days following publication of the final regulations in the *Federal Register*. Although the comment period for the proposed regulations has expired, the DOL has not indicated when final regulations will be published. If adopted in their current form, the proposed regulations would amend two existing sets of final regulations: the final QDIA regulations issued on October 24, 2007, and the final enhanced participant disclosure regulations issued on October 14, 2010. Both sets of changes are described in more detail below.

Changes to QDIA Notice Requirements

Pursuant to Section 404(c) of the Employee Retirement Income Security Act (ERISA), fiduciaries of individual account plans subject to ERISA are not responsible for a participant's investment decisions so long as, among other things, the participant has the right to exercise control over his or her investment decisions. This fiduciary protection previously was unavailable for default investment alternatives, or funds in which a participant's money is invested in the absence of an affirmative election. However, QDIA regulations extended Section 404(c) protection to default investment alternatives that satisfy certain requirements, including the provision of a QDIA notice by the plan fiduciary. See Final QDIA Regulations Require Immediate Consideration by Plan Fiduciaries for a description of the final QDIA regulations.

The existing QDIA regulations generally require provision of a QDIA notice to each participant or beneficiary who may have any portion of their account invested in the plan's QDIA. Since the publication of QDIA regulations, the DOL has received numerous questions on the required content of the QDIA notice because current QDIA regulations simply require the notice include a "description of the [QDIA], including a description of the investment objectives, risk and return characteristics (if applicable), and fees and expenses attendant to the [QDIA]." In light of these comments, the DOL's proposed regulations greatly expand and clarify the required content of QDIA notices, specifically requiring disclosure of all of the following:

- The QDIA's issuer and the QDIA's objectives or goals
- The QDIA's principal strategies and risks, including a general description of the types of assets held by the QDIA
- The QDIA's historical performance data, a statement indicating that a QDIA's past performance is not necessarily an indication of how the QDIA will perform in the future and, if applicable, a description of any fixed return, annuity, guarantee, death benefit or other ancillary features
- The QDIA's associated fees and expenses, including any annual operating expenses (expense ratio), any ongoing fees above annual operating expenses (mortality and expense fees) and any fees charged directly to the investment in connection with its acquisition, sale, transfer or withdrawal (commissions, sales loads, sales charges, deferred sales charges, redemption fees, surrender charges, exchange fees, account fees and purchase fees)
- If the QDIA is also a TDF, the notice must also include: an explanation of the asset allocation, how the asset allocation will change over time and the point in time when the QDIA will reach its most conservative asset allocation, including a chart, table or other graphical representation that illustrates changes in asset allocations over time; an explanation of the age group for whom the fund is designed, the relevance of the target date and any assumptions about a participant's or beneficiary's contribution and withdrawal intentions on or after such target date; and, if applicable, a statement that the participant or beneficiary may lose money by investing in the QDIA, including losses near and following retirement, and that there is no guarantee that the QDIA will provide adequate retirement income

In addition, the proposed regulations also clarify several items in existing QDIA regulations, relating to the plan fiduciary's responsibilities with respect to the provision of supplemental information following a participant's initial investment in the QDIA and to the provision of certain information upon participant request.

Expansion of Participant Disclosure Regulations to Include New TDF Notice Requirements

In November 2010 the DOL-issued regulations that require enhanced fee disclosures for participant-directed investments by defined contribution plans subject to ERISA. These 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. See Department of Labor Issues New Rules on 401(k) Fee Disclosure to Participants for a detailed explanation of these enhanced participant disclosure rules. The new proposed regulations add special disclosure rules for TDFs to the existing participant disclosure requirements.

One of the key requirements of the existing regulations is the disclosure of certain investment-related information in a model chart (or other comparative format), allowing participants to compare the investment-related information for each investment option offered under the plan. The proposed TDF regulations expand this comparative chart requirement, requiring plan administrators to provide the following TDF information in an appendix to the chart.

- An explanation of the TDF's asset allocation, how the asset allocation will change over time and the point in time at which the TDF will reach its most conservative asset allocation, including a chart, table or other graphical representation that illustrates such change in asset allocation over time
- If the TDF is named, or otherwise described, with reference to a particular 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
- A statement that the participant or beneficiary may lose money by investing in the TDF, including losses near and following retirement, and that there is no guarantee that the TDF will provide adequate retirement income

These requirements are identical to the proposed TDF requirements for QDIA notices described above. The DOL included expanded TDF requirements in both places to ensure that all participants and beneficiaries receive expanded disclosures and information about TDFs, not just those participants in a QDIA.

Due to the recent surge in TDF popularity, which was quickly followed by a rapid decline in TDF value (corresponding to the 2008 market decline), TDFs have also been subject to recent scrutiny by the U.S. Securities and Exchange Commission (SEC) and Congress. In response to investor concerns, the DOL and SEC jointly published an Investor Bulletin with helpful information for plan participants considering an investment in a TDF. The DOL also intends to publish a series of tips for plan fiduciaries' use in selecting and monitoring TDFs as investment options for participant-directed account plans. Finally, the SEC also recently issued a proposed rule that amends the current mutual fund marketing and advertising rules to include new disclosure requirements for TDFs. The proposed SEC disclosure rule is similar, but not identical, to the proposed DOL disclosure rule.

Steps for Plan Sponsors, Plan Fiduciaries and Plan Administrators

The proposed regulations will be effective 90 days following publication of the final regulations in the *Federal Register*. Although the comment period for the proposed regulations has expired, the DOL has yet to indicate when the final regulations will be published. In the meantime, plan sponsors, plan fiduciaries and plan administrators should familiarize themselves with the new regulations so they are prepared to comply with the new disclosure requirements when final regulations are issued.