LawFlash

DOL Amends Timing Requirement for Participant-Directed Plan Disclosures

March 23, 2015

The final rule gives greater leeway for the distribution deadline of annual participant disclosures.

In its 2010 participant disclosure rule for participant-directed individual account plans (Regulation 404a-5), the US Department of Labor (DOL) required that certain disclosures be provided on or before the date that a participant can first direct his or her investments and “at least annually thereafter.”[1] The DOL has now addressed questions and concerns regarding the timing of the annual disclosures.

Amended Timing Requirement

The 404a-5 disclosure rule requires that plan participants be furnished with specified information regarding their plans’ administrative fees and investment options at the time that they begin participating in the plan. The rule further requires, among other things, that this information be furnished again to all participants “at least annually.”

The original regulation defined “annually” as “at least once in any 12-month period.” In subsequent guidance, the DOL took the position that each annual disclosure must therefore be made no more than exactly one year—that is, 365 days—after the previous annual disclosure. At the same time, in response to concerns that this interpretation prevented plan administrators from consolidating these participant disclosures with other annual participant disclosures (for example, annual “safe-harbor” or “qualified default investment alternative” notices) subject to different deadlines, the DOL solicited comments on whether it should provide more flexibility to plan administrators (and provided a one-time extension to permit plan administrators to coordinate the timing of different annual disclosures). Another issue raised was that furnishing disclosure one year before the deadline would then move up the deadline for subsequent years—a deadline “creep,” so to speak.

In response to comments that support added deadline flexibility as benefiting plan participants, the DOL has now revised the definition to add a buffer period.[2] The amended definition defines “at least annually thereafter” to mean “at least once in any 14-month period,” an extension of two months (up to 62 days) from the prior definition. According to the DOL, this change should achieve the “correct balance” by ensuring that participants will receive these disclosures on a consistent and regular basis, without unwarranted delays between the disclosure dates, while at the same time offering plan administrators some flexibility.

Although the change is not effective until June 17 (90 days after publication), the DOL also announced that it is adopting a temporary enforcement policy, under which it will treat plan administrators as satisfying the annual notice requirement if they comply with the new definition based on having reasonably determined that doing so will benefit the plan participants. This effectively permits plan administrators to rely on the new definition prior to the effective date.[3]

The DOL noted that it had also requested comments on whether to change the definition of "at least quarterly," which describes the timing requirement for disclosures of administrative and individual expenses actually charged to participant accounts. Because no comments asked for a change to this definition, the DOL did not revise it. The DOL noted that the reason may be that prior DOL guidance provides a 45-day window for furnishing quarterly pension benefit statements and that the 404a-5 regulation permits the quarterly fee disclosures to be furnished with quarterly pension benefit statements, implying that people are reading the quarterly disclosure requirement under the 404a-5 regulation in light of the pension benefit statement guidance. The DOL did not comment on whether this is a reasonable interpretation, but also did not suggest otherwise.

Observations

This change provides needed flexibility to the deadline for furnishing the 404a-5 participant disclosures. The original interpretation raised many practical questions and complications around meeting the annual disclosure deadline. Although the DOL had provided a grace period to permit plan administrators to synchronize the 404a-5 annual disclosures with other plan annual disclosures, that grace period could only be used one time, and left the potential for future complications in the event of problems in meeting any one of the annual disclosures by the strict 365-day deadline.

The rulemaking is in the unusual form of a "direct final rule," meaning that it has been published as a final rule in the *Federal Register* without first being proposed with an opportunity for comment. The DOL did so on the basis that, having already solicited public comments (albeit in a field assistance bulletin rather than a proposed regulation), a proposed rulemaking is unnecessary. As such, there is a possibility that the DOL will be required to withdraw the rule in the event that it receives significant adverse comments within 30 days after publication (i.e., by April 20). Just in case, the DOL has concurrently published a notice of proposed rulemaking.[4] However, in view of the unanimously favorable comments on the issue, a need to withdraw the rule seems unlikely.

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[1] . Please see our LawFlash on the October 14, 2010 final regulations here.

[2] . Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans – Timing of Annual Disclosure; Direct final rule, 80 Fed. Reg. 14,301 (Mar. 19, 2015).

[3]. However, note that, as a technical matter, the DOL's temporary enforcement policy applies only to the DOL, not to plan participants.

[4]. Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans – Timing of Annual Disclosure; Proposed rule, 80 Fed. Reg. 14,334 (Mar. 19, 2015).

- See more at: https://www.morganlewis.com/pubs/dol-amends-timing-requirement-for-participant-directed-plan-disclosures#sthash.JLtCGctX.dpuf

LawFlash

A Divided SEC Proposes CEO Pay Ratio Disclosure Rules

September 23, 2013

On September 18, 2013, a divided SEC voted 3-2 to propose rules requiring U.S. public companies to disclose the ratio of the annual total compensation of the CEO to the median annual total compensation of all employees, better known as “pay ratio” disclosure.[1] The Staff considered nearly 23,000 comment letters prior to issuing the proposal, and has included in the proposal many additional requests for public comment. There is a 60-day public comment period after publication in the federal register.

It is generally expected that final rules will not be adopted until 2014 and will not be effective until 2015. This means that a company with a December 31 fiscal year end must include pay ratio disclosure for fiscal year 2015 in its proxy statement for the 2016 annual meeting of stockholders. The new rules will not apply to foreign private issuers, MJDS filers, emerging growth companies or smaller reporting companies. Newly public companies that do not fit into one of these categories will have a one year grace period following an IPO before becoming subject to the rules.

Background

Section 953(b) of the Dodd-Frank Act, enacted in July 2010, requires the SEC to amend executive compensation disclosure rules to require reporting companies to disclose:

- The median of the annual total compensation of all employees, except the CEO;
- The annual total compensation of the CEO; and
- The ratio of the median of annual total employee compensation to the annual total compensation of the CEO.

Until now, companies have not been required to disclose detailed compensation information for employees other than the CEO or the other named executive officers.

Summary of Proposal

The proposed rules amend Item 402 of Regulation S-K to include a new paragraph (u). The SEC stated throughout the proposal that it drafted the rules to provide “significant flexibility” to companies in meeting this new and potentially burdensome disclosure requirement.

Some key highlights of the proposal include:

- **Flexibility in Determining the Median Employee.** There is no required methodology to calculate the median employee. Rather, a company is free to select a methodology that is appropriate to its size and structure. For example, a company could identify a median employee by applying a consistent compensation measure (i.e. salary plus bonus, using payroll records), or could

calculate the “total compensation” (as defined under Item 402(c) of Regulation S-K) for each employee included in the calculation, and then determine the median. Companies may use statistical sampling, or may include in the calculation the entire employee population.

- **Use of Reasonable Estimates.** Once the median employee is identified, the company must calculate that employee’s total compensation as is determined under Item 402(c) of Regulation S-K. This means including salary, bonus, stock and option awards, change in pension value, non-equity incentive plan compensation, nonqualified deferred compensation earnings and all other compensation for the last completed fiscal year. Companies may use reasonable estimates in these calculations.
- **All Employees Covered.** Full-time, part-time, temporary, seasonal and non-U.S. employees (whether employed by the company or a subsidiary) employed as of the last day of the prior fiscal year must all be considered in the calculation. Companies may annualize the total compensation for an employee who did not work for the entire year, but may not adjust for part-time, temporary or seasonable workers, or make cost-of living adjustments for foreign workers.
- **Disclosure of Methodology, Assumptions and Estimates Required.** Companies must include disclosure of the methodology and any material assumptions, adjustments or estimates used to determine the median employee and/or to calculate the median employee’s annual total compensation. For example, if a company uses payroll records to determine the median employee, the company would be required to disclose that methodology. If statistical sampling is used, the sample size, the estimated entire population size and any assumptions used in determining sample size must be disclosed. If estimated amounts are used (whether used in calculating the median employee or annual total compensation), the company must disclose which amounts were estimated and the methods used for the estimation. Companies may, but need not supplement their disclosure with additional discussion or other ratios.
- **Required in SEC Filings that Require Item 402 Information.** The pay ratio disclosure, which may be expressed as a ratio or by narrative, will be required in all SEC filings that must already include executive compensation information under Item 402. These include registration statements, proxy and information statements, and annual reports. Companies may decide where within the filing to include the new information. There is no requirement to include pay ratio disclosure or to update pay ratio disclosure with respect to its last completed fiscal year until the filing of a company’s annual report or proxy or information statement. Pay ratio disclosure will be deemed “filed”, not “furnished”, for purposes of the Securities Act and Exchange Act and subject to the potential liabilities thereunder.

Conclusion

While the proposed rules provide some welcome flexibility, compliance is still likely to require the expenditure of significant resources, especially for large, multinational companies. It remains to be seen whether such disclosure will prove helpful to investors in understanding a company’s compensation philosophy and decision making.

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[1] http://www.sec.gov/rules/proposed/2013/33-9452.pdf

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