

FINAL DOL RULE ON ERISA BLACKOUT PERIOD NOTIFICATION REQUIREMENTS UNDER THE SARBANES-OXLEY ACT

In General. In our December 2002 Alert¹ we discussed a Department of Labor (“DOL”) interim final rule implementing Sarbanes-Oxley Act (“Act”) amendments to ERISA that require the administrator of any individual account plan (*i.e.*, a defined contribution plan such as a 401(k) plan, profit sharing plan, or ESOP) to give 30 days’ advance written notice of blackout periods to participants and beneficiaries whose rights under the plan are temporarily suspended, limited, or restricted by the blackout period (“affected participants”) and to issuers of employer securities subject to the blackout period.² The DOL has now issued a final rule effective 1/26/03 (“Final Rule”)

which adopts the interim final rule (“Proposal”) with certain clarifications and minor modifications. This Alert summarizes the Final Rule and highlights material differences from the Proposal.

“Blackout Period” Definition. For purposes of the ERISA notice requirement, the Act defines “blackout period” as a period of more than 3 consecutive business days during which the otherwise available right of a plan participant or beneficiary to direct or diversify plan account balances or to obtain loans or distributions from the plan is temporarily suspended, limited or restricted. The Proposal excepted from the definition of “blackout period” a suspension, limitation or restriction that (1) results from application of the securities laws (*e.g.*, insider trading restrictions applicable to certain public company executives), (2) is regularly scheduled and results from a plan amendment that is adequately disclosed to affected participants, or (3) is a consequence of a qualified domestic relations order.

The Final Rule incorporates the Act’s definition of “blackout period,” but clarifies and expands the exceptions contained in the Proposal. First, for purposes of (2) above the Final Rule provides that the exception applies to preexisting plan features as well as to plan amendments, and expands the types of documents through which “adequate disclosure” to affected participants may be made. For purposes of (3) above, the Final Rule provides that the exclusion applies during the pendency of a domestic relations order determination and is not limited to restrictions

¹ Copies of our December 2002 Alert entitled “Proposed Securities and Exchange Commission and Final Department of Labor Rules on Employee Benefit Plan Blackout Period Provisions of the Sarbanes-Oxley Act” can be obtained on the firm’s website at www.kirkland.com, as can a new separate Alert on the final blackout period rule issued by the Securities and Exchange Commission also effective 1/26/03.

² This notice requirement applies to individual account plans maintained by public and private companies, but not to governmental plans, foreign plans or non-electing church plans. The Act also expressly excludes “one-participant retirement plans” from the blackout period notice requirements. For this purpose a “one-participant retirement plan” is a plan that (1) covers only the employer (and his spouse) where the employer owns the entire business or covers only one or more partners (and their spouses) in a business partnership, (2) meets the minimum coverage requirements of § 410(b) of the Internal Revenue Code without being aggregated with any other plan that covers employees of the business, (3) does not provide benefits to anyone except the employer or the partners (and their spouses), (4) does not cover a business that is a member of a controlled group, and (5) does not cover a business that leases employees.

arising only after a final determination that a domestic relations order is qualified. In response to comments the Final Rule also excepts from the “blackout period” definition account restrictions triggered by individual participant actions, *e.g.*, receipt of a tax levy, a dispute over a deceased participant’s account, failure of a participant to obtain a PIN number, or allegations that the participant committed a fiduciary breach or crime involving the plan. Finally, the preamble to the Final Rule states that a permanent (as opposed to temporary) elimination of certain rights is not a blackout period.³

Content of Participant/Beneficiary Notice. The Act provides that the blackout notice must be written in a manner calculated to be understood by the average plan participant and must contain (1) the reasons for the blackout period, (2) an identification of the investments and other rights affected, (3) the expected beginning date and length of the blackout period, (4) when investment rights will be affected, a statement that participants or beneficiaries should evaluate the appropriateness of their current investment decisions in light of their inability to direct or diversify assets credited to their accounts during the blackout period,⁴ and (5) such additional information as may be required by the DOL pursuant to regulations. The notice must be in writing, although the Act permits electronic or “other form” of dissemination to the extent reasonably accessible to the participant.⁵

The Final Rule adopts the Proposal’s requirement that the notice include a description of all rights otherwise available under the plan that will be temporarily suspended during the blackout period (*e.g.*, right to direct or diversify assets in individual accounts, right

to obtain loans from the plan, right to obtain distributions from the plan) in addition to the identification of the investments subject to the blackout period. However, the Proposal had specified that the notice must contain the expected beginning date and ending date of the blackout period -- not just the “expected beginning date and length” as stated in the Act. In response to concerns raised by commentators, the Final Rule permits the notice to describe the length of the blackout period by reference to either (1) the expected beginning date and ending date of the blackout period, or (2) the calendar week(s) during which the blackout period is expected to begin and end, provided that during such weeks information regarding whether the blackout period has begun or ended is readily available without charge to affected participants.

The Proposal also required the notice to contain the name, address and telephone number of the plan administrator or “other person” responsible for answering questions about the blackout period. The Final Rule clarifies that the contact person need not be an individual, but must be “a sufficiently specific source for answering questions concerning the blackout period that participants and beneficiaries will not be confused as to whom their questions should be addressed” (*e.g.*, reference to a human resources department is sufficiently specific). Thus, the Final Rule states that the required information must be provided with respect to a “contact” rather than a “person.”

In the event that the notice is not provided within the 30-day advance period required by the timing provisions of the Act, the notice must also contain (1) a statement that Federal law generally requires that notice be furnished at least 30 days in advance of the last date on which affected participants could exercise the affected rights prior to commencement of a blackout period,⁶ and (2) an explanation of the reasons why at least 30 days’ advance notice could not be furnished.

³ Examples would include (1) a permanent restriction on new contributions to an investment option, (2) replacement of one investment option with another of a similar type, and (3) termination of a plan.

⁴ The Final Rule provides that this particular notice requirement is deemed satisfied by use of the advisory statement contained in paragraph 4 of the model notice.

⁵ Under the Proposal a blackout notice would be considered furnished as of the date of first class mailing or as of the date of electronic transmission. The Final Rule further provides that a blackout notice will also be considered furnished on the date of mailing if by certified mail or express mail, or on the date of delivery to a “designated private delivery service.”

⁶ The Final Rule provides that this specific notice requirement is deemed satisfied by use of the statement contained in paragraph 5 of the model notice.

Timing of Participant/Beneficiary Notice. The Final Rule retains the Proposal's requirement that notice must be provided to affected participants at least 30 calendar days and not more than 60 calendar days in advance of the last date on which they could exercise rights before the start of a blackout period. Thus, under certain circumstances the Final Rule will require that notice be provided more than 30 days in advance of a blackout period. The Final Rule provides as an example a plan that allows participants to direct their investments during the first 15 days of each month and which will be subject to a suspension of investment direction rights from the 1st to 15th of May in order to accommodate a change in recordkeepers. If the 30-day notice period were counted from the date immediately preceding the start of the blackout period, notice could be provided on April 1st. However, under the Final Rule the notice must be provided no later than March 16th, *i.e.*, at least 30 days in advance of April 15th, which is the last date on which participants could exercise the affected rights immediately before the start of the blackout period. The Final Rule states that where a blackout period is identified as beginning during the week of, *e.g.*, February 9, the blackout period is deemed to begin on February 9 (*i.e.*, the Sunday of the applicable week) for purposes of the notice timing requirements.

The Act provides that the 30-day advance notice requirement may be shortened or eliminated if a plan fiduciary makes a written determination (which must be signed and dated by the fiduciary) that (1) the advance notice requirement would otherwise interfere with the plan administrator's fiduciary duties or (2) the plan administrator's inability to provide advance notice was due to unforeseeable circumstances beyond the plan administrator's reasonable control. An example of the circumstances described in (1) would be the filing of bankruptcy by a company where a plan administrator determines that it would not be prudent to continue to permit participants to direct investments into company stock. An example of the circumstances described in (2) would be a major computer failure which, for some period of time, incapacitates a program for recording and processing loans and distributions from a plan. In all such events, the blackout notice must be provided "as soon as reasonably possible" unless providing the notice prior to the end of the blackout period is "impracticable." However, if the blackout period occurs solely in

connection with a participant or beneficiary becoming or ceasing to be a participant or beneficiary by reason of a merger, acquisition, divestiture or similar transaction, the blackout notice must simply be provided "as soon as reasonably practicable" and no written fiduciary determination is required.

If there is a change in a blackout period's beginning or ending date after the notice has been provided, the plan administrator must give written notice of the change to affected participants "as soon as reasonably practicable." The updated notice must explain the reasons for the change in date(s) and identify all material changes in the information contained in the previous notice.

The Final Rule adopts the provisions of the Proposal with respect to timing of the blackout period notice, but also clarifies that no exception from the timing requirements is made for new plan participants. However, if an employee becomes a participant after blackout notices have been furnished to other participants then the administrator may provide the notice to the new participant "as soon as reasonably possible."

Public Company Notice Requirement. The Act provides that a plan administrator must give "timely" notice to an "issuer" of any employer securities affected by a defined contribution plan's blackout period (*e.g.*, if a blackout period will restrict participant trading or other rights in connection with an employer stock fund).⁷ The Final Rule states that the timing and content requirements applicable to notices provided to affected participants also apply to the issuer notice, except that notice to the issuer need not include (1) the statement advising affected participants to review their investments prior to commencement of the blackout period, and (2) the general statement of the 30-day notice requirement and explanation of any

⁷For purposes of the Final Rule, "issuer" means a company (1) with equity or debt securities traded on a national securities exchange, or (2) with a class of equity securities held by 500 or more shareholders of record, or (3) required to file 1934 Act §15(d) reports with the SEC (*i.e.*, a company which has previously sold equity or debt securities pursuant to a 1933 Act registration statement, until the registered securities are held by less than 300 persons on the first day of a subsequent fiscal year), or (4) which has filed a 1933 Act registration statement, not yet effective and not withdrawn.

failure to comply. The Final Rule also states that the notice may be provided to the issuer's agent for service of legal process unless the issuer has provided the plan administrator with the name of another person for service of notice; and the Final Rule clarifies that if an issuer has designated the plan administrator as the person to be furnished the blackout notice, the issuer notice is deemed given on the same day notice is provided to affected participants (thereby relieving the administrator of the obligation to notify itself of a blackout period). The issuer notice must be in writing except to the extent the person to whom notice must be furnished consents to receive the notice in electronic or other form.

Penalties. The Act creates a new ERISA civil penalty in connection with the blackout period notice requirement.⁸ Specifically, if a plan administrator fails or refuses timely to provide a blackout notice to plan participants and beneficiaries, the DOL may assess a civil penalty of up to \$100 per participant and beneficiary for each day of the plan administrator's failure or refusal. The Final Rule adopts the Proposal, which clarified the extent to which a plan administrator is liable for partial compliance failures and set forth procedures under which a penalty reduction or waiver may be obtained. In general, the amount of the penalty assessed for each separate violation of the blackout notice requirement will be determined by the DOL, taking into consideration the degree and/or willfulness of the failure or refusal to provide the notice. The amount assessed for each violation cannot exceed \$100 per day computed from the date of the administrator's failure or refusal to provide notice up to and including the final day of the blackout period, but such a failure or refusal for any single participant or beneficiary is

treated as a separate violation.⁹ Before assessing a penalty the DOL will give the plan administrator written notice of the penalty amount, the number of participants and beneficiaries at issue, the period to which the penalty applies, and the reasons for the penalty. In accordance with procedures set forth in the Final Rule, the DOL may waive all or part of the penalty if the plan administrator can either establish compliance with the rules or present evidence of mitigating circumstances regarding the degree of willfulness of the failure to comply.

The Final Rule also provides that all administrators of an affected plan are jointly and severally liable for a blackout notice compliance failure, and states that any resulting penalties cannot be paid from plan assets.

Effective Dates and Plan Amendments. The Act's blackout notice provision is effective 1/26/03. If the provision requires a plan amendment (*e.g.*, because the plan document's language requires an amendment or future regulations require an amendment), the plan amendment is not required to be made before the first plan year beginning on or after 1/26/03 (*i.e.*, by 12/31/04 for a calendar year plan). However, starting on 1/26/03 the plan must be operated in good faith compliance with the new notice provision and any plan amendment must be retroactively effective to 1/26/03. The Final Rule is effective for any blackout period commencing on or after 1/26/03 and further provides that, for the period 1/26/03 to 2/25/03, plan administrators must furnish any required blackout notice as soon as reasonably possible.

Form and Content of Model Notice. The following is the model blackout period notice issued under the Final Rule, revised to reflect changes from the Proposal as described above. Use of the model notice is not mandatory, and with regard to all information except that provided in paragraphs 4 and 5 of the model notice compliance with the notice content requirements of the Act will "depend on the facts and circumstances" of the particular blackout period and plan.

⁸ In addition to the new civil penalty the Act enhances ERISA's criminal penalties. Under the Act, any individual willfully violating the blackout notice requirement or any other ERISA disclosure or reporting requirement (*e.g.*, the willful failure to provide a summary plan description or a summary annual report, or to file a required Form 5500 annual report) is subject to a criminal fine up to \$100,000 (previously \$5,000) and/or 10 years' imprisonment (previously 1 year); and any violator that is not an individual (*i.e.*, a corporation or other business entity) is subject to a criminal fine up to \$500,000 (previously \$100,000). The Final Rule does not address the ERISA criminal penalty provisions.

⁹ Thus, the maximum penalty is \$100 times the number of days starting from the date that the administrator failed to provide notice through the last day of the blackout period times the number of participants and beneficiaries who should have been provided notice.

Important Notice Concerning Your Rights Under the

[Enter Name of Individual Account Plan]

[Enter Date of Notice]

1. This notice is to inform you that the [enter name of plan] will be [enter reasons for blackout period, as appropriate: changing investment options, changing recordkeepers, etc.].

2. As a result of these changes, you temporarily will be unable to [enter as appropriate: direct or diversify investments in your individual accounts (if only specific investments are subject to the blackout, those investments should be specifically identified), obtain a loan from the plan, or obtain a distribution from the plan]. This period, during which you will be unable to exercise these rights otherwise available under the plan, is called a “blackout period.” Whether or not you are planning retirement in the near future, we encourage you to carefully consider how this blackout period may affect your retirement planning, as well as your overall financial plan.

3. The blackout period for the plan [enter the following as appropriate]: is expected to begin on [enter date] and end on [enter date]/is expected to begin during the week of [enter date] and end during the week of [enter date]. During these weeks, you can determine whether the blackout period has started or ended by [enter instructions for use of toll-free number or accessing website].

4. *[In the case of investments affected by the blackout period, add the following:* During the blackout period you will be unable to direct or

diversify the assets held in your plan account. For this reason, it is very important that you review and consider the appropriateness of your current investments in light of your inability to direct or diversify those investments during the blackout period. For your long-term retirement security, you should give careful consideration to the importance of a well-balanced and diversified investment portfolio, taking into account all your assets, income and investments.][If the plan permits investments in individual securities, add the following: You should be aware that there is a risk to holding substantial portions of your assets in the securities of any one company, as individual securities tend to have wider price swings, up and down, in short periods of time, than investments in diversified funds. Stocks that have wide price swings might have a large loss during the blackout period, and you would not be able to direct the sale of such stocks from your account during the blackout period.]

5. *[If timely notice cannot be provided, enter:* (A) Federal law generally requires that you be furnished notice of a blackout period at least 30 days in advance of the last date on which you could exercise your affected rights immediately before the commencement of any blackout period in order to provide you with sufficient time to consider the effect of the blackout period on your retirement and financial plans. (B) [Enter explanation of reasons for inability to furnish 30 days advance notice.]]

6. If you have any questions concerning this notice, you should contact [enter name, address and telephone number of the plan administrator or other contact responsible for answering questions about the blackout period].

Should you have any questions about this Alert, please contact the Kirkland & Ellis employee benefits attorney with whom you normally work, or any of the following:

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