

TO: Clients and Friends

FROM: Employee Benefits & Executive Compensation Group

DATE: February 3, 2003

RE: Final Rules on Notice Requirements for Blackout Periods in Individual Account Plans

The Sarbanes-Oxley Act of 2002 (“SOA”)¹ added a new Section 101(i) to ERISA which requires a plan administrator to provide written notice to affected plan participants and beneficiaries in individual account plans 30 days in advance of certain plan “blackout periods.” Blackout periods typically occur as a result of a change in a plan’s recordkeeper, a change in investment alternatives, and mergers, acquisitions and other corporate transactions which affect a plan’s coverage. The Department of Labor issued interim final rules relating to the notice requirements which we discussed in an earlier client memorandum. On January 24, 2003, the Department of Labor issued final regulations. This memorandum updates our earlier client memorandum to reflect the final regulations.

Covered Plans

- The notice rules apply to virtually all individual account plans covered by ERISA, such as 401(k) plans, profit sharing plans, money purchase pension plans, stock bonus plans and ESOPs, as well as many nonqualified “top-hat” plans.

Effective Date

- The final rules and the notice requirements are effective for blackout periods commencing on or after January 26, 2003.

Blackout Periods Defined

- A temporary suspension, limitation or restriction **for more than three consecutive business days** of a participant’s or beneficiary’s rights otherwise available under the plan to direct or diversify investments credited to their account, obtain loans or obtain distributions.

¹ For more information on SOA, Shaw Pittman’s Directors’ Guide to SOA is available at www.shawpittman.com

- Blackouts covered in the notice rule do not include suspensions or limitations:
 - (1) which occur by reason of the securities laws,
 - (2) which are regularly scheduled suspensions, limitations or restrictions under the plan (or changes thereto) which have been previously disclosed in the summary plan documents, investment materials or other materials forwarded to participants and beneficiaries,²
 - (3) which occurs by reason of a qualified domestic relations order or a pending determination by the plan administrator or a court whether a domestic relations order filed (or reasonably anticipated to be filed) is a qualified order, or
 - (4) which occur by reason of an act or failure to act by a participant or a claim by unrelated party solely with respect to an individual participant (e.g. suspension of the right to obtain a loan due to default on a prior loan).

Sponsors of plans with participant direction of investment in the employer's equity securities should immediately review their plan materials to be sure those materials describe any regularly scheduled periods when, pursuant to the employer's insider trading policies, trading in the employer's securities held by the plan is not permitted. Failure to properly disclose these regularly scheduled trading blackouts may result in these employer-imposed trading limitations being subject to the new 30-day notice requirement. Plan sponsors should also consult with counsel on whether these trading restrictions should be included in the official plan document or whether inclusion in other plan materials is sufficient to comply with both the ERISA rules described in this memorandum and the securities laws restrictions for blackouts which apply under Section 306 of SOA.³

Contents of Notice

The notice must be written in a manner calculated to be understood by the average participant and is to include the following:

- (1) The reason for the blackout.
- (2) A description of the rights otherwise available to participants or beneficiaries that are to be temporarily suspended or limited, including identification of any investments subject to the blackout.

² The preamble to the final regulations clarify that scheduled freezes on trading in employer securities, such as trading freezes timed to coincide with quarterly earnings releases, may be treated as regularly scheduled, provided they are described in plan materials and properly disclosed to affected participants and beneficiaries.

³ Because a trading blackout in employer securities is usually imposed by a plan sponsor in order to comply with its insider trading policy, a policy which is not adopted in a plan fiduciary capacity with respect to the plan, consideration should also be given as to whether the trading restrictions should be imposed by amendment to the official plan document adopted by the plan sponsor in its "settlor" capacity.

- (3) The length of the blackout period by reference to either the expected beginning and ending date of the blackout or the calendar week during which the blackout is expected to begin and end. If only the expected beginning and ending week are identified, information as to whether the blackout has begun or ended must be available without charge, such as by website or toll free number.
- (4) In the case when investments are affected, “a statement that the participant or beneficiary should evaluate the appropriateness of their current investment decisions in light of their inability to direct or diversify assets in their account during the blackout period.”
- (5) If the notice is not provided at least 30 days prior to the last date on which participants may exercise rights affected by the blackout, a statement that 30 days notice is generally required under Federal law and explanation of why at least 30 days advance notice could not be provided. This statement is not required if the third exemption from the 30-day requirement discussed below (relating to mergers and similar transactions) applies to the situation.
- (6) The name, address and telephone number of the Plan Administrator or other contact responsible for answering questions.

A copy of the sample notice provided by the Department of Labor is attached at the end of this memorandum.

Timing for Providing the Notice

- For blackouts commencing after February 25, 2003, the notice is to be provided at least 30 days and not more than 60 days prior to the last day on which participants and beneficiaries may exercise the rights affected by the blackout.
- For blackout periods commencing on or after the effective date of January 26, 2003, but not later than February 25, 2003, a transition rule permits the notice to be provided as soon as reasonably possible.
- The requirement that the notice be provided at least 30 days prior to the last day on which participants may exercise the rights affected by the blackout does not apply in the following situations:
 - (1) If the deferral of the blackout period to comply with the 30-day notice requirement would result in a violation of the exclusive purpose and prudence rules of ERISA Sections 404(a)(1)(A) or (B). The preamble to the final regulations provides, for example, that if an employer announces it is filing for bankruptcy, the plan fiduciary might determine that it is imprudent to permit continued investment in employer securities, effective immediately.
 - (2) If the inability to provide advance notice was unforeseeable or beyond the reasonable control of the plan administrator. The preamble to the final regulations provides, as an example, an unforeseeable computer problem that prevents loan and distribution processing and which will take 10 days to fix.

- (3) If the blackout relates to one or more participants or beneficiaries solely in connection with their becoming or ceasing to be a participant or beneficiary as a result of a merger acquisition, divestiture or similar transaction.

In the first and second situation, the exemption from the 30-day requirement is available only if the plan fiduciary documents the fiduciary's determination of the basis for the exemption in a writing which is dated and signed. Also, in such cases the explanation for why the 30-day advance notice requirement was not met must be included in the notice of the blackout when it is provided. In all three situations, notice must be provided to be affected participants and beneficiaries as soon as possible, unless notice in advance of termination of the blackout is impracticable.

- If the length of the blackout period changes after the notice is provided, the administrator must provide an updated notice explaining the reasons for the change and identifying all material changes to the prior notice. This notice must be provided to all affected participants and beneficiaries as soon as reasonably possible, unless notice in advance of the blackout period is impracticable.

When Employer Securities Are Involved

- If employer securities of an issuer⁴ as defined in Section 3 of the Securities Exchange Act of 1934 are held by a plan and are subject to the blackout period, a notice (or updated notice) must also be provided to the issuer by providing notice to the issuer's agent for service of legal process or other person designated by the issuer to the plan administrator as the person to receive such notice. Since notice of this information means that under Section 306(a) of SOA a blackout may apply to any trading in the issuer's stock by the officers and directors of the issuer, who along with the Securities and Exchange Commission must be notified of the blackout,⁵ we recommend that an issuer designate its officer responsible for insider trading compliance as the person to receive this notice.⁶

Method of Delivery

- The notice may be furnished by any method which is generally permitted under ERISA for complying with disclosure obligations. Thus, personal delivery, first-class mail and electronic methods are permissible. Electronic methods must comply with Department of Labor guidelines for electronic delivery of disclosure documents.
- A notice sent by first class mail or by electronic transmission is considered furnished on the date of mailing or electronic transmission. If the notice is delivered by an IRS

⁴ An issuer includes a company the securities of which are registered under Section 12 of the Securities Exchange Act of 1934 or that is required to file reports under Section 15(d) of such Act or that files or has filed a registration statement under the Securities Act of 1933 which has not yet become effective and has not yet been withdrawn.

⁵ Note that the definition of a "blackout" in SOA for purposes of the securities law restriction in trading by officers and directors is not the same as that used in Section 101(i) of ERISA and as described in this memorandum.

⁶ This notice must be furnished in writing, except to the extent the person to whom the notice must be furnished consents to receiving notice in electronic or other form. If the plan administrator is designated to receive the notice on behalf of the issuer it need not send a notice to itself.

approved overnight private delivery service, the notice is considered furnished when delivered to the delivery service. When other methods of delivery are used, such as interoffice mail or hand-delivery, the notice will typically be treated as furnished on the date of receipt by the participant or beneficiary.

Penalty of Failure to Provide Notice

- The Department of Labor may assess a penalty of up to \$100 **per day per each affected participant or beneficiary** for a failure or refusal to comply with the notice requirements. The penalty period begins when the notice should have been given and does not end until the blackout is over. The penalty amount may be reduced based on a showing by the plan administrator of mitigating circumstances regarding the degree or willfulness of the non-compliance.

Model Notice for Blackout Period⁷

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 [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 toll-free number or accessing web site].

4. *[In the case of investments affected by the blackout period, add the following:* During 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 [i.e., this notice is being furnished later than 30 days in advance other than a blackout solely relating to participants or beneficiaries becoming or ceasing to be participants or beneficiaries as a result of a merger, acquisition or similar transaction⁸] 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].

⁷ From Final Regulations 29 C.F.R. 2520.101-3 (68 Fed. Reg. 3716, 1-24-03).

⁸ Comment added to model notice for clarity.