A MILLIMAN GLOBAL FIRM
Milliman USA
Consultants and Actuaries

CLIENT ACTION BULLETIN

July 31, 2002 **CAB 02-13**

Corporate Auditing Law's Effects on Employee Benefit Plans

SUMMARY

The comprehensive corporate accounting and auditing reforms that the President signed into law yesterday contain several significant provisions affecting employee benefit plans, particularly 401(k) and other participant-directed defined contribution plans. The Sarbanes-Oxley Act of 2002 ("the S-O Act," P.L.107-204): requires advance notices if a plan will suspend transactions for a blackout period lasting longer than three consecutive business days; imposes restrictions on company stock trades by the firm's executives and directors if most plan participants are prohibited from trading; and substantially increases penalties for notification or reporting violations under the Employee Retirement Income Security Act (ERISA) for all covered plans.

The increased penalties under ERISA are effective immediately. The S-O Act's provisions concerning blackout periods are effective January 26, 2003, with any necessary plan amendments to be adopted – and given retroactive effect – by the end of the plan year that begins after the effective date (e.g., by December 31, 2004 for calendar-year plans).

DISCUSSION

Participant Notification of Upcoming Blackouts

Defined contribution plans typically restrict the ability of participants to direct investments or make other transactions during periods of system upgrades or problems, when changing service providers, or for various other reasons. During these "blackout" periods, administrative functions initiated by participants are often put on hold until the systems are ready to resume normal operations. The S-O Act provides for new participant notification procedures if the blackout is expected to last for more than three consecutive business days.

The new law requires plan administrators to provide, in writing or electronically, notices to affected participants 30 days in advance of the blackout period. The notice must specify: the blackout dates; the investment and other participant rights affected by the blackout; and the reason for the blackout. If participants' ability to direct investments is affected, the notice must include a statement that participants should evaluate their current investment decisions in light of the upcoming inability to direct or diversify investments. If the timing of the blackout changes after providing the notice, plan administrators must give participants a new notice describing the change as soon as practicable.

Failure to provide participants a notice will subject the plan administrator to a civil penalty of up to $100 per day per participant.

Advance notices are not required for blackout periods that are:

- regularly scheduled periods of restriction that are incorporated into the plan language and timely disclosed before employees become participants; or
- imposed solely in connection with a corporate merger, acquisition, divestiture, or similar transaction.

If the 30-day advance notice requirement cannot be met due to unforeseeable events or circumstances beyond the reasonable control of the plan administrator, or if delaying the timing of the blackout would violate fiduciary standards, then the plan administrator must provide the notice as soon as reasonably possible. In either of these cases, a plan fiduciary must make his or her determination in writing. Without such a written record, the above civil penalties would apply.

Restrictions on Stock Sales or Purchases by Executives and Directors

If a blackout period curtails the ability of more than 50% of participants (counting all defined contribution plans of the plan sponsor) to buy or sell company stock, the firm's executives and directors must be restricted from trading company stock acquired based on their employment relationship.

Similar exceptions to the participant blackout notification requirements apply to the limitation on executive and director stock trading.

The plan administrator must timely notify the company stock issuer of upcoming blackout periods that restrict trading so that the company can provide a separate notice of the upcoming restriction to the affected executives and directors. The company also must timely file this separate notice with the Securities and Exchange Commission (SEC).

Increased ERISA Criminal Penalties

Any person who willfully violates any ERISA provision requiring a notice or reporting to participants or a reporting to a government entity (e.g., filing Form 5500) may be subject to substantially increased criminal penalties in addition to any specified civil penalties. The maximum penalties for an individual are increased from $5,000 to $100,000, while the maximum jail time is increased from one year to 10 years. For violations by an entity other than a person, the maximum penalty is increased from $100,000 to $500,000.

ACTION

Plan sponsors and administrators affected by the new law should take steps to ensure open communications with their recordkeeping service providers about any potential upcoming blackout periods. Policies and procedures to provide the multiple types of required notices to participants, officers, directors, and the SEC whenever blackouts occur must be established. The civil and criminal penalties for noncompliance with the S-O Act's new requirements should provide a strong incentive for strict adherence to the rules.

Additional interpretative rulings and model notices will be forthcoming from the Department of Labor.

For more information on implementing the requirements of the S-O Act, please contact your Milliman consultant.

Milliman USA's *Client Action Bulletin* contains general information that is not intended to constitute the rendering of legal, tax, investment, or accounting advice. Application to specific circumstances should rely on further professional guidance.

© 2002 Milliman USA