ERISA and SEC Prospectus Disclosures for Company Stock Funds

A Lexis Practice Advisor® Practice Note by
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This practice note discusses the disclosures required under the Employee Retirement Income Security Act (ERISA) and the Securities Act of 1933 (Securities Act), when a publicly traded company maintaining a defined contribution plan includes a company stock fund as a permissible participant-directed investment. It also discusses the advantages and disadvantages of combining the plan's summary plan description (SPD) and the required securities prospectus information for the employer securities held in the company stock fund.

This practice note addresses the following topics:

- What Is a Company Stock Fund?
- General ERISA Disclosures for Employer Securities in Plans Providing Participant-Directed Investments
- Prospectus Requirements When Offering a Company Stock Fund Investment in a 401(k) Plan
- Combining a Plan SPD with a Prospectus for a Company Stock Fund Investment
- Risks of Incorporating Prospectus Information in SPDs
- Alternatives to Combining the Plan SPD and Prospectus for a Company Stock Fund Investment

For information about other ERISA and Internal Revenue Code limitations that apply when ERISA plans invest in employer securities, see Employer Stock in Retirement Plans Resource Kit.

What is a Company Stock Fund?

Public companies that sponsor 401(k) plans may offer a company stock fund for participant investment. The fund will permit the purchase of the plan sponsors or its publicly traded affiliate's common stock by plan participants. Typically, so that the investment looks and trades like a mutual fund, the fund is organized in units, not shares of stock. To do so, the fund is designed to include the requisite employer company's stock plus sufficient cash to maintain fund liquidity. The ratio of cash to stock will vary. Providing a unit value also allows recordkeepers to value the cash and stock held in the investment daily, applying unit accounting methods. The disclosure rules discussed in this practice note apply regardless of whether or not the fund is unitized or holds full and partial shares for participant investment.

While company stock funds have given rise to litigation, typically in the form of so-called stock drop suits, they offer some advantages to sponsors. For example, the corporation is eligible for a tax deduction on cash dividends paid on the plan's shares, or reinvested in additional units, which amounts would otherwise not be deductible. I.R.C. § 404(k). Investing in company stock within a qualified plan also has tax benefits for the participant. If the

participant ultimately receives a lump-sum distribution of his or her account in shares of the employer stock, the participant will not be taxed at that time on the net unrealized appreciation (NUA) of the shares. NUA is the appreciation in the value of the shares since the time it was purchased by the plan. The NUA becomes subject to income tax upon the participant's subsequent sale of the shares, at capital gain rates instead of the generally higher ordinary income rates. I.R.C. § 402(e)(4)(B); 26 C.F.R. § 1.402(a)-1(b)(1)(i).

For a discussion on the tax benefits under I.R.C. § 404(k) of paying or reinvesting dividends earned on company stock held in an employer's company stock fund, see Lexis Explanation I.R.C. § 404(k). Also, see Lexis Tax Advisor -- Federal Topical § 1C:16B.04 for a further discussion on the treatment of NUA.

General ERISA Disclosures for Employer Securities in Plans Providing Participant-Directed Investments

Two laws govern the disclosure compliance requirements for publicly traded companies that sponsor or maintain a 401(k) plan which permits participant-directed investment in a company stock fund. These two laws are ERISA, which governs general participant disclosures to plan participants, and the Securities Act, which prescribes in the instructions to the Form S-8 securities registration filing what to disclose in a prospectus to be delivered to plan participants who are eligible to invest in the employer securities held in the company stock fund.

Generally, ERISA attorneys draft SPDs and other participant disclosures while securities attorneys prepare and file Forms S-8 with the SEC and draft the prospectus required when a company registers plan shares on a registration statement. Prospectus disclosures share several ERISA disclosure requirements included in an SPD or for an individual account plan providing participant-directed investments. 29 C.F.R. § 2520.102-3; 29 C.F.R. § 2550.404a-5; 17 C.F.R. § 230.428. The required prospectus for a company stock fund often is drafted as an integral part of the plan's ERISA participant disclosures, principally the plan's SPD. But, as discussed in this practice note, practitioners have three ways to manage the prospectus requirement:

- **Solution 1: Fully integrate documents.** Practitioners can fully integrate the SPD with the prospectus, except for parts of the prospectus that are SEC filings incorporated by reference, as discussed in Combining a Plan SPD with a Prospectus for a Company Stock Fund Investment
- **Solution 2: Separate the SPD and prospectus.** For this option, practitioners can draft separate documents; some common (duplicative) disclosures will appear in the SPD and in the separate prospectus. See Alternatives to Providing a Prospectus Separately from the SPD under Combining a Plan SPD with a Prospectus for a Company Stock Fund Investment
- **Solution 3: Partially integrate documents.** For a hybrid approach, practitioners can draft a separate prospectus addressing the prospectus requirements of Part 1 of Form S-8 that do not already appear in a separate SPD (e.g., regarding plan eligibility and how to purchase or exchange units in the company stock fund, etc.). The separate SPD will be labeled to indicate it is part of the prospectus, the bulk of which appears in a separate document. See Alternatives to Combining the Plan SPD and Prospectus for a Company Stock Fund Investment.

General SPD requirements

SPDs are a required disclosure for ERISA employee benefit plans, like 401(k) plans. They must be drafted to be accurate and comprehensive to reasonably inform plan participants and beneficiaries of their rights and obligations under the employee benefit plan. ERISA § 102 (29 U.S.C. § 1022). ERISA regulations specify the information that the SPD for an ERISA pension plan must include. 29 C.F.R. § 2520.102-3. For example, in addition to providing participants with information about the type of plan, the plan sponsor, and identifying the

plan's named fiduciaries, the SPD must describe circumstances that may result in any loss of or diminution of benefits, including from:

- Disqualification
- Ineligibility
- Denial
- Loss
- Forfeiture
- Suspension
- Offset –or–
- Reduction under the plan

29 C.F.R. § 2520.102-3(l). While the Department of Labor's (DOL) SPD regulations do not themselves require additional disclosures related to plans with company stock fund investments, certain securities disclosure requirements duplicate information already required in an SPD, as discussed below in Prospectus Requirements When Offering a Company Stock Fund Investment in a 401(k) Plan – Securities Act Rule 428: The Prospectus. This is one reason many employers combine the SPD and the securities prospectus for a plan that offers a company stock fund investment.

For additional discussion on SPD requirements, see Summary Plan Description Resource Kit.

ERISA Disclosure Requirements for Plans with Participant-Directed Investments or Company Stock Funds

Additional participant disclosure requirements apply to plans, like most 401(k) plans, that provide for participant-directed investments. Those disclosures arise not from DOL regulations addressing SPDs, but rather from two sets of DOL regulations that apply to individual account plans (defined at ERISA § 3(34) (29 U.S.C. § 1002(34)) that permit participant-directed investments (which may or may not also permit participant investment in employer stock).

Participant Disclosure Rules for All Participant-Directed Investment Plans

All individual account plans providing for participant-directed investments (other than simplified employee plans (SEPs)) are required to comply with DOL regulations requiring a flow-through of information regarding the identification and performance of the plan's designated investment alternatives, plan fees, and other plan information. These rules derive from the prudence and loyalty requirements to which plan fiduciaries are subject under ERISA. 29 C.F.R. § 2550.404a-5(a) (participant disclosure final regulations published in 75 Fed. Reg. 64,909 (Oct. 20, 2010)).

With limited exception, plan administrators must provide the same information to participants under the participant disclosure rules regarding a company stock fund investment as they must do for any other plan investment fund. See 29 C.F.R. § 2550.404a-5(b)(1). The following additional disclosures (or exclusions) apply:

- **Plan diversification language.** In lieu of identifying the principal strategies and risks of the company stock fund (as otherwise required under 29 C.F.R. § 2550.404a-5(d)(1)(v)(C)), plan administrators should describe the importance of investment diversification. You can use the general statement under "The Importance of Diversifying Your Retirement Savings" in the model notice set forth in I.R.S. Notice

2006-107, 2006-2 C.B. 1114 (describing disclosures required for plans offering investments in employer securities under ERISA § 204(j) (29 U.S.C. § 1054(j)) and I.R.C. 401(a)(35)).

- **Portfolio turnover rate.** Plan administrators do not have to provide portfolio turnover rate information for the company stock fund (as is required for other plan investment options under 29 C.F.R. § 2550.404a-5(d)(1)(v)(D)).
- **Fee and expense, annual operating expenses information, and per $1,000 invested.** The rules requiring plan administrators to provide (1) fee and expense information; (2) total annual operating expenses; and (3) total annual operating expenses expressed as a dollar amount of each $1,000 invested, as required under 29 C.F.R. § 2550.404a-5(d)(1)(v)(F), (d)(1)(iv)(A)(ii), and (iii), respectively, continue to apply for unitized funds, but not where the fund trades in shares of employer securities.
- **Determining 1-, 5-, and 10-year performance data.** When satisfying the rules requiring plan administrators to provide performance data for an investment option for the 1-, 5-, and 10-year periods, the term "average annual total return" is given a different meaning where the common stock fund is not traded in units of participation (as many are).

29 C.F.R. § 2550.404a-5(i)(1)(i)–(vi). For a fuller discussion on these participant disclosure rules, see Employee Benefits Law § 12.10, at paragraph [1][c].

Section 404(C) Safe Harbor Plans

Although employers who sponsor individual account plans (which includes all defined contribution plans) need not design their 401(k) plan to allow participant-directed investments, almost all 401(k) plans do. Most of these plans also are designed to qualify for the safe harbor fiduciary relief under Section 404(c)(1) of ERISA. This safe harbor relieves plan fiduciaries from liability for participant investment losses that result from any participant's investment decisions under the plan's investment options. ERISA § 404(c)(1) (29 U.S.C. § 1104(c)(1); 29 C.F.R. § 2550.404c-1 (Section 404(c) safe harbor plans).

Section 404(c) safe harbor plans must satisfy the following general requirements:

- Investment menu. Participants must have the opportunity to select from a broad range of at least three investment alternatives with materially different risk and return characteristics so that, taken together, they give participants the opportunity to diversify investments minimizing the risk of large losses.
- Plan design and investment trading/exchanges. Participants must be allowed to make investment changes at least quarterly, for the three core investments and, further, must be permitted to change investments with reasonable frequency, considering the market volatility of the investments.
- Information and disclosure. Participants must be provided specific information to assure that the participants can make informed investment decisions.

29 C.F.R. § 2550. 404c-1. For a discussion of the specific requirements for a 404(c) safe harbor plan, see ERISA § 404(c) and QDIA Safe Harbors and Disclosure Rules for SPDs, Participant-Directed Plans, Employer Securities, and Blackout Notices.

Special Section 404(C) Rules for Participant-Directed Investment Plans Offering Qualifying Employer Securities

Section 404(c) safe harbor plans offering employer stock for participant investment must ensure that the stock constitutes qualified employer securities (QES). Without QES status, the employer stock held in the plan would

be subject to the ERISA rule that limits plan investment in employer securities to 10% of the value of the plan (measured at the last day of the prior plan year). ERISA § 407(a) (29 U.S.C. § 1107(a)). To qualify for QES status, and an exception to the 10% rule, the company stock must be (1) publicly traded common stock of the plan sponsor or its affiliate and (2) held in an eligible individual account plan like a 401(k) plan. ERISA § 407(b), (d)(1), (d)(5) (29 U.S.C. § 1107 (b), (d)(1), (d)(5)).

Plans offering employer securities as an available investment option must also satisfy additional requirements to qualify for Section 404(c) safe harbor relief in transactions involving the company stock. These requirements relate to the marketability of the securities, ensuring that participants who invest in a company stock fund receive the same shareholder information as holders of the individual employer security plus special safeguards. These disclosures include information about employer securities held in the company stock fund, such as:

- Flow-through of voting rights
- Required recordkeeping and confidentiality safeguards –and–
- Appointment of an independent fiduciary in appropriate circumstances (such as when the employer securities are subject to a tender offer)

29 C.F.R. § 2550.404c-1(d)(2)(ii)(E)(4).

Prospectus Requirements When Offering A Company Stock Fund Investment in A 401(K) Plan

Section 5 of the Securities Act (15 U.S.C. § 77e) requires that all offers and sales of securities in the United States be registered under the Securities Act unless an exemption from registration is available. A public company that maintains a 401(k) plan (or other individual account plan) that allows participants to invest salary deferrals and other voluntary employee contributions in employer securities must register the securities with the SEC. See SEC Rel. 33-6188, 45 Fed. Reg. 8,960 (Feb. 11, 1980), as amended by SEC Rel. 33-6281, 46 Fed. Reg. 8,446 (Jan. 27, 1981) and SEC Form S-8 and instructions.

A Form S-8 registration statement, which is used for registering shares to be offered in an employee benefit plan, becomes effective immediately upon filing with the SEC, pursuant to Securities Act Rule 462(a) (17 C.F.R. § 230.462). The Form S-8 registers (1) the employer securities to be issued to plan participants and (2) plan interests (which are considered separate securities by the SEC) for any 401(k) plan that allows participants to invest in employer securities.

You must file the registration statement and deliver the Section 10(a)(3) prospectus (prospectus) for the company stock fund to eligible participants (except for the documents incorporated by reference therein) before any contributions are made by plan participants to the company stock fund. This topic is discussed further below in Combining a Plan SPD with a Prospectus for a Company Stock Fund Investment – Prospectus Delivery.

Sec Form S-8 Prospectus Requirements for a Company Stock Fund

Companies must register their shares offered for sale in a 401(k) plan (or other employee benefit plan, like an employee stock purchase plan) regardless of whether the shares for the plan will be purchased on the open market, issued from treasury, or newly issued by the company. Once registered, unless an exemption applies (as it will for a stand-alone employee stock ownership plan to which only the employer contributes), Section 5(b)(2) of the Securities Act prohibits the delivery of the security (here, offered as a 401(k) plan investment option) unless accompanied or preceded by a prospectus that satisfies the requirements of Section 10(a) of the Securities Act

(15 U.S.C. § 77j). The prospectus will contain facts about the plan and, by incorporating documents filed by the registrant with the SEC by reference, also about the registrant, its finances, management, and other information that informs investors in deciding whether to purchase the security. While the prospectus must be delivered to plan participants (as discussed below) it is not filed with the SEC.

For more information about preparing and filing Form S-8, including preparation of the required prospectus, see Form S-8 Registration Statement Drafting and Filing.

Securities Act Rule 428: The Prospectus

Rule 428 sets forth the documents that will constitute a prospectus designed to satisfy the requirements of Section 10(a) of the Securities Act, and that must be delivered, or made available to, participants in a plan for which a company (the registrant) registers those shares on Form S-8. 17 C.F.R. § 230.428(b)(1). The required prospectus disclosures appear in the Instructions to Form S-8, Part I ("Information Required in a Section 10(a) Prospectus"), Items 1 and 2, and Part II ("Information Required in the Registration Statement"), Item 3 setting forth documents to be incorporated in the prospectus by reference. SEC Form S-8 and instructions.

A compliant prospectus includes (1) general plan information and (2) items that can be incorporated by reference (i.e., the registrant's SEC filings), as follows:

1. General plan information. This is information about the plan and its operations that enable participants to make informed decisions about their plan investing, consisting of the following information specified in Form S-8 General Instructions Part I, Item 1, subsections (a)–(j):
    - **Provide required plan information:**
        - **Plan name and registrant.** The prospectus should identify the name of the plan and the registrant (i.e., the employer whose securities are being offered by the plan).
        - **Nature and purpose of the plan.** The prospectus should identify the (1) general name and purpose of the plan, including its expected duration (e.g., indefinite); and (2) provisions for its modification, earlier termination, or extension.
        - **ERISA requirements applicable to the plan.** The prospectus should state whether the plan is subject to any provisions of ERISA (as it will be for a qualified 401(k) plan) and the general nature of those provisions.
        - **Contact information and capacity.** The prospectus should provide addresses and telephone numbers that participants can use to obtain additional information about the plan and its administrators along with a description of material relationships between the administrators, the issuer, and its employees. It should state the capacity in which plan administrators (which includes the plan administrator, the custodian, trustees, and any investment managers) act and the functions they perform. The prospectus should also:
            - Identify if individuals or entities other than participating employees have investment discretion and identify over what portion of the plan, providing names and policies followed for the type and portion of the plan over which they have investment control.
            - Where the plan is not subject to ERISA, (1) state the nature of material relationships between the administrators and employees, the registrant, and affiliates; and (2) describe the manner that the plan administrator is selected, its term and manner of removal. SEC Form S-8 and instructions, Part I, Item I(a).

- **Describe the securities to be offered.** The prospectus must provide information about the securities offered:
  - It should disclose the title and total amount of securities to be offered (e.g., Company XYZ common stock; 1,000,000 shares).
  - Unless common stock registered under Section 12 of the Securities Exchange Act of 1934 (Exchange Act) is offered (as is almost always the case, so the information is typically unnecessary), information required under Item 202 of Regulation S-K (17 C.F.R. § 229.202) which includes information concerning the shares' dividend rights, terms of conversion, redemption provisions, voting rights, including any provisions specifying the vote required by security holders to take action, and other attributes of ownership. SEC Form S-8 and instructions, Part I, Item I(b).
- **Identify eligible employees.** The prospectus must include a description of each class or group of employees who may participate in the plan and the basis for determining plan eligibility. SEC Form S-8 and instructions, Part I, Item I(c).
- **Identify procedures for purchasing, holding, and restricting investment in plan investment options (and the common stock fund).** The prospectus must disclose information regarding:
  - The time within which employees can elect to participate in the plan (which, in a 401(k) plan likely will be continual); and whether there is any limit on the amount or percentage of employer securities that can be purchased.
  - State when and the manner that employees (or participants) pay for employer securities, such as by payroll deduction (which is the common method for employee salary deferral contributions) and identify the permitted percentage(s) of compensation that can be used in computing such contributions and how employees may modify their amount.
  - Where contributions are made under the plan by the registrant or any other employer, state (1) who can make those contributions, (2) when they are to be made and determining their amount, and (3) the basis for calculating those contributions (if not fixed).
  - The nature and frequency of reports to participating employees as to the amount and status of their accounts (e.g., by web portal 24/7 and as required by ERISA § 105(a) (29 U.S.C. § 1025(a)). SEC Form S-8 and instructions, Part I, Item I(d).
- **Identify applicable resale restrictions**. Disclose in the prospectus any resale restrictions (e.g., some company stock funds limit transactions to one purchase or one sale within a 30-day period). SEC Form S-8 and instructions, Item 1(e).
- **Indicate tax effects**. Disclose in the prospectus the tax effects of plan participation including the fact that the plan is (or is not) qualified under I.R.C. § 401(a). SEC Form S-8 and instructions, Part 1, Item 1(f).
- **Describe the investment funds and provide 1-, 2-, and 3-year performance data for each**. Include a list of all plan investment options, including a comparative table of financial data for investment options for each of the last three years (plus additional years, as reasonable to keep information from being misleading) to apprise employees of the material trends and significant changes in the investment options. SEC Form S-8 and instructions, Part I, Item I(g).
- **Identify plan forfeiture conditions and withdrawals**. Provide information about (1) the participant's ability to withdraw funds from the plan, the participant's ability to assign the participant's plan account (other than a qualified domestic relations order), and (2) events that could result in a plan forfeiture or penalty, and the consequences thereof. SEC Form S-8 and instructions, Part I, Item I(h), (i).
- **Identify plan charges and deductions**. Describe charges against the participant's account or an investment fund and indicate who (or what entity) will receive directly or indirectly, any part thereof.

Include information regarding charges upon termination or withdrawal. SEC Form S-9 and instructions, Part I, Item 1(j).

2. **Documents incorporated by reference and available on request.** A Form S-8 incorporates by reference certain documents (i.e., the information in documents filed by the registrant under the Exchange Act is deemed included in the Form S-8 prospectus) as follows, together with all subsequent Exchange Act filings:
    - Most recent annual report on Form 10-K (or latest prospectus filed under the Securities Act or effective Exchange Act registration statement) and, where plan interests are being registered, the plan's latest annual report
    - All other Exchange Act reports (i.e., quarterly reports on Form 10-Q and current reports on Form 8-K)filed pursuant to Section 13 or Section 15(d) since the end of the fiscal year covered by the Form 10-K
    - If the class of securities to be offered under the plan is registered under the Exchange Act, the description of the securities contained in a registration statement filed under the Exchange Act, including any amendment or report filed to update the description

SEC Form S-8 and instructions, Part II, Item 3. The prospectus must state that any of these documents are available to participants, on oral or written request and without charge, and that the prospectus incorporates them by reference. The statement must include the address (with the responsible individual's title or department) and telephone number to which the request should be directed. SEC Form S-8 and instructions, Part I, Item 2.

SEC Form S-8 and instructions. Note that, to comply with the final prospectus requirement above (Part I, Item 2), plan counsel or personnel must collect and maintain a file for all documents that are incorporated in the prospectus by reference. The file must be available to participants upon request.

For an additional discussion on the Form S-8 prospectus requirements, see Form S-8 Registration Statement Drafting and Filing — Preparing the Form S-8 Registration Statement – Part I: Information Required in the Section 10(a) Prospectus.

Combining A Plan SPD With A Prospectus for a Company Stock Fund Investment

As is evident, many (but not all) Form S-8, Part I, requirements are similar to information already required for an SPD. For this reason, many plan sponsors find it expedient to combine the plan's SPD with the prospectus for a company stock fund. Following this integrated approach participants are also more likely to readily find all the plan information they require in one document. This integration is permissible provided:

- The SPD includes all material plan information required by Item 1 of Form S-8 (that is common for an SPD and a prospectus).
- The SPD also includes the other required prospectus information not otherwise required under the SPD regulations.

Prospectus Format

While an SPD may not be comprised of more than one document (with limited exception for different eligible groups) unless it includes summary of material modifications (SMM) updates, a prospectus may be comprised of one or more documents or a section within a document. However, as discussed below, due to modifications and items incorporated by reference, the prospectus is more likely to be a fast-growing set of documents, unlike an SPD.

Use of One Or More Documents

Rule 428(a)(1) provides that the registrant may designate an entire document or portions of a document as constituting part of the Section 10(a) prospectus. 17 C.F.R. § 230.428(b)(1)(ii). The regulations recommend using section headings to accomplish designation of a portion of a document as the prospectus. Id. The benefit of using multiple documents is more apparent if the plan sponsor decides to separate the prospectus and the SPD, as discussed in Alternatives to Combining the SPD and Prospectus below.

Legend and Date Requirements for Any Document (or Part of A Document) That Constitutes a Prospectus

The prospectus rules require that a date is displayed on any document that:

- Constitutes part of the prospectus –or–
- Contains portions constituting part of the prospectus

17 C.F.R. § 230.428(b)(1)(iii). This is important when assembling a file that will include the prospectus and all documents that are incorporated into the prospectus by reference. See 17 C.F.R. § 230.428(a)(2). Thus, any prospectus, SPD, or SMM that is being provided as a SEC prospectus must bear a publication date and include the following sentence in a conspicuous place in the forepart of the document:

> **This document** [or identify specifically designated portions of this document] **constitutes part of a prospectus covering securities that have been registered under the Securities Act of 1933.**

Id. The legend typically appears on the front of the prospectus, whether standalone, combined with the SPD, in a supplemental prospectus or in an SMM that is a prospectus update.

Updating the Prospectus and SPD

The rules regarding SPD update require changes every five or 10 years, depending on the materiality of the changes. 29 C.F.R. § 2520.104b-2(b)(1). Interim updates can be provided using a summary of material modification that need not be delivered sooner than 210 days (seven months) after the plan year in which the sponsor adopts a material plan modification. 29 C.F.R. § 2520.104b-3.

Rule 428(b)(1)(i) requires registrants to timely update a prospectus “in a timely manner” and “in writing” to reflect any material changes in the information during any period offers and sales of the securities are made. 17 C.F.R. § 230.428. For this purpose, “in a timely manner” means “prior to offers and sales of the registrant’s securities.” Delivery of an updated prospectus must precede or accompany offers or sales of the registrant’s securities in order to comply with Securities Act § 5(a). Securities Act of 1933, 15 U.S.C. § 77a. For 401(k) plans, which generally permit daily purchases and sales of plan investment options, like a company stock fund,
material changes in the terms of the plan affecting investment in the company stock fund must be disclosed in a prospectus supplement prior to the effective date of the change.

Further, Rule 428(b)(1)(iv) requires that documents containing the plan information sent or given to newly eligible participants be revised if documents updating information (i.e., previously issued prospectus supplements) “have obscured the readability of the plan information or render it confusing.” 17 C.F.R. § 230.428(b)(1)(iv). To accomplish the update, wherever required, the registrant may provide updated information in a prospectus supplement or in a revised prospectus. So, unlike delivery requirements for an SMM (i.e., 210 days after the plan year-end), plan administrators may need to update the combined plan/prospectus information much sooner. See ERISA §§ 102(a), 104(b)(1)(B); (29 U.S.C. §§ 1022, 1024(b)(1)(B)); 29 C.F.R. § 2520.104b-2(b)(1), (2).

Automatic Updates of the Prospectus

Section 10(a)(3) of the Securities Act (15 U.S.C. § 77j) provides that when a company uses a prospectus more than nine months after the effective date of the registration statement (which includes an S-8 registration statement), the information in it cannot be older than 16 months. For S-8 registration statements, this requirement should not be a compliance issue as it is satisfied automatically by filing the registrant company's annual report on Form 10-K (or 20-F or 40-F, if applicable) with the SEC, so long as the prospectus incorporates (as it should) the Form 10-K by reference. A company's quarterly reports on Form 10-Q and current reports on Form 8-K are also incorporated by reference into the prospectus and serve to keep the company information in the prospectus current.

Prospectus Delivery

You must file the Form S-8 registration statement and deliver to eligible participants a Section 10(a)(3) prospectus (except for the documents incorporated by reference therein) before any contributions are made by plan participants to the company stock fund.

In addition, the registrant company must concurrently deliver to each eligible person, a copy of any one of the following:

- The registrant's annual report to security holders containing the information required by Exchange Act Rule 14a-3(b) (17 C.F.R. § 240.14a-3(b))
- The registrant's annual report on Form 10-K, Form 20-F, or, if applicable, Form 40-F
- The latest prospectus filed pursuant to Securities Act Rule 424(b) (17 C.F.R. § 230.424(b)) that contains audited financial statements for the registrant's latest fiscal year, provided that the financial statements are not incorporated by reference from another filing, and provided further that such prospectus contains substantially the information required by Exchange Act Rule 14a-3(b) (17 C.F.R. § 240.14a-3(b))–or–
- The registrant's effective Exchange Act registration statement on Form 10, Form 20-F, or, if applicable, Form 40-F, containing audited financial statements for the registrant's latest fiscal year

The registrant also must deliver, promptly and without charge, to each participant to whom information is required to be delivered, upon written or oral request:

- A copy of the information that has been incorporated by reference pursuant to Part II, Item 3 of Form S-8 (without exhibits; e.g., the latest (1) annual report, (2) proxy, or (3) prospectus for the registered shares)
- Where plan interests are registered, a copy of the then latest annual report of the plan filed pursuant to Section 15(d) of the Exchange Act, whether on Form 11-K or included as part of the registrant's annual report on Form 10-K

Additional Materials to Participants Who Invest in Company Stock

Companies are also required to deliver to all participants in a plan fund that invests in employer securities, copies of all reports, proxy statements, and other communications delivered to security-holders generally, no later than when the material is sent to the registrant's other security holders.

Method of Delivery

A company may deliver hard copies of the prospectus and accompanying or requested documents or may deliver them electronically in accordance with the SEC's guidance, set forth in SEC release nos. 33-7233 (October 6, 1995) 1995 SEC LEXIS 2662, 60 Fed. Reg. 53458, and 33-7289 (May 9, 1996) 1996 SEC LEXIS 1299.

The SEC's guidance permits a registrant to deliver the prospectus (and all documents required to accompany the prospectus) electronically to all employees who use the company's email system in the course of performing their work or who have other ways of receiving electronic messages from the company (e.g., by obtaining them from a secretary or co-worker). The email may announce the availability of the documents and provide information as to how to access them. Alternatively, the documents may be attached to the email.

The rules indicate that a company need not obtain employees' consent to receiving e-delivery (although consents must be obtained from any plan participants who are no longer employed by the company) but must make sure that employees either (1) receive the materials or have easy access to them and (2) must advise employees of the right to receive hard copies on demand. Access to documents not included as attachments to the email must be simple and straightforward, requiring only a few clicks at most to reach the materials. The plan prospectus may be hosted on the company's local area network or intranet, or the website of the brokerage firm that administers the plan.

Differences for ERISA Documents

The SEC electronic delivery rules are somewhat more liberal than are the ERISA rules set forth in 29 C.F.R. § 2520.104b-1(c). The ERISA rules require that an employee be assigned an office computer to rely on electronic delivery. This removes from electronic delivery employees who (without having provided consent) may have to rely on an open computer kiosk to access their email or employer communications. Former employees and other nonemployee participants need to consent to receiving electronic communications as well as satisfy computer hardware requirements. It is best therefore to rely on the less liberal ERISA electronic delivery rules where an ERISA and prospectus disclosure are combined.

For information on the ERISA rules for electronic delivery, see Electronic Disclosure Rules (ERISA Safe Harbor).

Prospectus Record Retention Requirements

You (or per your instruction, the registrant company) should maintain a file of the documents that, at any time, are treated as part of the prospectus for the company stock fund, except those documents required to be incorporated by reference in the registration statement pursuant to Item 3 of Form S-8. Maintain each document in the file for at least five years after the document was last used as part of the prospectus. If the SPD is being used as part of the prospectus, treat the entire SPD document as part of the prospectus file. See Rule 230.428(a)(2) (17 C.F.R. 230.428(a)(2)) and Form S-8 and instructions.

Upon request, the company must furnish the SEC a copy of any documents included in the file.

Risks of Incorporating Prospectus Information in SPDs

Registrants and their counsel should be cautious about combining in a single document the prospectus for a company stock fund and the plan SPD. It is also important to stay informed of the evolving case law as detailed below.

ERISA Fiduciary Liability for Providing Misleading Securities Filing Information

A concern exists whether filing or providing prospectuses for a defined contribution plan's company stock fund can give rise to a claim for breach of fiduciary duty (e.g., if the information provided is misleading). See Employee Compensation and Benefits Tax Guide P 1204, paragraph 1204.1. The underlying principles are not in dispute. ERISA requires that a fiduciary must act with "the care, skill, prudence, and diligence under the circumstances

then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." See ERISA § 404(a) (29 U.S.C. § 1104(a)). By integrating the prospectus and SPD for a 401(k) plan's company stock fund, the plan fiduciaries may risk being held liable for information not only appearing in the combined document but also for those SEC filings that become incorporated by reference.

Prospectus Misstatements Not Treated as ERISA Fiduciary Breaches

In Varity Corp. v. Howe, the Supreme Court ruled that ERISA subjects fiduciaries to liability for misleading plan participants and beneficiaries through material misstatements. 516 U.S. 489, 506 (1996). However, it is equally true under ERISA that a corporation and its corporate board members are allowed to wear two hats: that of a corporate employer and that of an ERISA fiduciary. In Varity, the employers argued that the relevant ERISA section imposed liability only upon plan fiduciaries; the allegedly misleading communications were made as an employer and not as a plan fiduciary, and were thus not actionable. ERISA liability can only arise from actions taken in the performance of ERISA fiduciary obligations. Varity corp., 616 U.S. 489 at 498, 506. As a result, "the threshold determination in making out an ERISA claim of misrepresentation is whether the decision taken was a business management decision or whether it was an action falling within the fiduciary functions delineated by ERISA." See Vartanian v. Monsanto Co., 880 F. Supp. 63, 70 (D. Mass. 1995). The issue is relevant as courts have looked to whether a misstatement in a prospectus relates to a fiduciary or settlor function, only the former leading to ERISA liability.

The several cases discussed below illustrate where a misstatement in a prospectus lead to a claim for breach of ERISA fiduciary duty.

- **In re Textron (First Circuit district court).** As one example of the type of claim that can be made, in Textron, plaintiffs in alleged that their employer made misstatements in its SEC filings that affected the value of shares of Textron common stock held in the plan's Textron stock fund. In re Textron, Inc. ERISA Litig., 2011 U.S. Dist. LEXIS 100209 (D.R.I. 2011). Plaintiffs argued that the misstatements qualified as fiduciary communications because the company's SEC filings were incorporated into the plan's prospectus. Since the prospectus had been provided to plan participants, plaintiffs argued, it therefore became a fiduciary communication. Additionally, the plan's SPD stated that participants could receive upon request copies documents incorporated by reference in the prospectus, such as Textron's annual Form 10-K, Form 11-K, and any other reports filed with the SEC. However, the SPD also stated that "neither the prospectus nor the SEC filings that are made a part of the prospectus are incorporated by reference into the SPD."

  The court dismissed the participants' claims, concluding that the defendants were acting in a corporate capacity under federal securities laws when they made the statements at issue in the case. The fact that the filings were made available to plan participants was not sufficient to transform them into fiduciary communications. The court recognized that plan participants had a right to expect that defendants would not make any materially misleading statements in their SEC filings, but any such cause of action that plan participants had should be brought under the securities laws rather than ERISA.
- **JPMorgan Chase Litigation (Second Circuit).** Similarly, in the JPMorgan Chase ERISA Litigation, in a district court lying in the Second Circuit, the plan's SPD stated that "the prospectus is a separate document unrelated to the summary plan description, and the financial statements referred to by it, and incorporated by reference therein." Here, too, misleading statements in financial statements that were incorporated by reference into the prospectus were deemed not to have not been prepared pursuant to fiduciary duties imposed by ERISA. In re JPMorgan Chase & Co. ERISA Litig., 2016 U.S. Dist. LEXIS 2709 (S.D.N.Y. 2014).

- **Glaxosmithkline ERISA Litigation (Second Circuit).** Likewise, in this case, the Court of Appeals for the Second Circuit held that SEC filings were not created by GSK in its capacity as plan administrator. Glaxosmithkline ERISA Litigation. Gum v. GlaxoSmithKline Ret. Sav. Plan Comm. (In re Glaxosmithkline ERISA Litig.), 494 Fed. Appx. 172 (2d Cir. 2012). The court also concluded that it could not be inferred that individual plan administrators had made intentional and knowing misstatements by incorporating GSK's SEC filings into the SPDS. Thus, the general allegation that these administrators should have known of the material misrepresentations and omissions filed with the SEC did not state a plausible claim for breach of fiduciary duty. The court further stated that it declined to require plan administrators to perform an independent investigation of SEC filings before incorporating them into SPDs.
- **Kirchenbaum v. Reliant Energy (Fifth Circuit).** The Court of Appeals for the Fifth Circuit addressed the question whether the company's change in business strategy made it imprudent for the plan fiduciaries to continue investing in the employer's common stock. Because the plan (an employee stock ownership plan required to invest primarily in employer securities) requirements to invest in employer stock were mandatory and treated as such by the employer and committee, no fiduciary duties were inherent in the plan other than to follow its terms. Kirschbaum v. Reliant Energy, Inc., 526 F.3d 243, 246 (5th Cir. 2008). The Fifth Circuit reasoned that the misrepresentations were not actionable under ERISA because they were only contained in a plan's S-8 registration. The defendant was obligated to file those documents under the securities laws and did not disseminate them to plan participants.

Prospectus Misstatements Treated as ERISA Fiduciary Breaches

However, several cases illustrated have concluded that the decision as to what to include in the SPD is itself a fiduciary act. Consequently, a misstatement in a prospectus may lead to an ERISA breach of fiduciary liability.

- In Re Dynegy ERISA Litigation (Fifth Circuit district court). The cases described above, such as Textron, are distinguishable from In Re Dynegy, Inc. ERISA Litigation, in which a District Court held that misrepresentations in SEC filings that had been incorporated into the SPD became actionable when the company encouraged the plan participants to review the filings carefully. Schied v. Dynegy, Inc. (In re Dynegy, Inc. ERISA Litig.), 309 F. Supp. 2d 861, 890 (S.D. Tex. 2004). The court reasoned, consistent with Varity, that such a communication was sufficiently related to benefits decisions to be deemed fiduciary in nature, thereby triggering a duty to speak truthfully and thus to investigate before speaking. In re Dynegy, Inc. ERISA Litig. 889–90. The district court concluded, however, that had the fiduciaries not disseminated the information, they would not have had an independent duty under ERISA to investigate and correct statements about the stock made by non-fiduciaries via securities filings.
- **Dudenhoeffer v. Fifth Third Bank (Sixth Circuit).** In Dudenhoeffer v. Fifth Third Bank, the Court of Appeals decided two issues, although the Supreme Court granted certiorari only with respect to the issue of the Moench presumption. Dudenhoeffer v. Fifth Third Bancorp, 757 F. Supp. 2d 753 (S.D. Oh. 2010) rem'd Fifth Third Bancorp v. Dudenhoeffer, 134 S. Ct. 2459 (2014). The second issue was an issue that no Circuit Court of Appeals had addressed, namely whether the express incorporation of SEC filings into an ERISA mandated SPD is a fiduciary communication. In that regard, reference the amicus brief produced by the DOL. Dudenhoeffer Amicus Brief, in support of appellants. Most importantly in Dudenhoeffer, the Sixth Circuit agreed with the decisions in Kirchenbaum (above) and Lanfear (below), to the extent they held that "the preparation, signing, and filing of [Securities and Exchange Commission (SEC) documents are not fiduciary acts under ERISA. However, the Court held that incorporating SEC documents by reference into the plan's summary plan description was a fiduciary act because the defendants 'were undertaking an ERISA-mandated fiduciary duty-the provision of information to plan participants through the required SPD.'" The court thus found that the plaintiffs plausibly alleged that the fiduciaries breached their duties by communicating any misleading information that may have been included in the SEC filings.

The Court of Appeals for the Sixth Circuit did not address what actions a plan fiduciary must take to satisfy its fiduciary obligation before incorporating by reference SEC filings in an SPD. The most cautious course of conduct would be to independently review the contents of the SPD to determine whether they were materially misleading. The alternative would be to consider whether a reasonable fiduciary would believe the SEC filing to be substantially accurate so that it could be incorporated by reference without line by line scrutiny. The plan fiduciary would consider whether the incorporated documents were facially compliant with SEC requirements, had been prepared by competent personnel, and had received proper legal and accounting review. The argument would be that if these standards were satisfied, there would be no liability for breach of fiduciary duty if misleading statements in the SEC filings were later discovered. In lieu of this uncertainty and in the face of three Court of Appeals decisions and a clearly articulated position of the DOL, two practical alternatives are simply to file two separate documents or reverse the process and rather than incorporate the prospectus into the SPD, incorporate the SPD into the prospectus.

- **Rinehart v. Akers (Ninth Circuit).** In Rinehart v. Akers, the Court of Appeals expressly indicated its agreement with the Sixth Circuit's decision in Dudenhoeffer, as did the Court of Appeals for the Ninth Circuit in Harris v. Amgen. Rinehart v. Akers, 722 F.3d 137 (2nd Cir. 2013). That position also reflects the position of the DOL. In a number of briefs, it has stated that an SEC communication in and of itself is not an ERISA communication. However, when it is incorporated into plan documents such as an SPD and a statement is made telling participants to look at the plan documents, that incorporation is a fiduciary act and the duty to be truthful to participants applies to the documents included by reference as much as it does to the SPD.
- **Harris v. Amgen (Ninth Circuit).** When the defendants in this case filed the Form S-8 and created and distributed the stock prospectuses, they were acting in their corporate capacities and not in their capacity as ERISA fiduciaries. Harris v. Amgen, Inc., 738 F.3d 1026 (9th Cir. 2013). However, defendants did more than merely file and distribute the documents as required by the securities laws. They prepared and distributed SPDs explicitly incorporating by reference Amgen's SEC filings, including Amgen's recent 10-K and 8-K filings for which they knew or should have known included statement that, incorporated by reference into the SPDs, were materially false and misleading.
- **Lanfear v. Home Depot (Eleventh Circuit).** The Court of Appeals for the Eleventh Circuit followed Kirschbaum (see above) in Lanfear v. Home Depot, Inc. with a different result. The Eleventh Circuit agreed with the decisions in Kirschbaum to the extent they held that "the preparation, signing, and filing of SEC documents are not fiduciary acts under ERISA. However, the court held that incorporating SEC documents by reference into the plan's summary plan description was a fiduciary act because the defendants "were undertaking an ERISA-mandated fiduciary duty-the provision of information to plan participants through the required SPD." The court found that the plaintiffs plausibly alleged that the fiduciaries breached their duties by communicating any misleading information that may have been included in the SEC filings.

Alternatives To Combining The Plan SPD And Prospectus for a Company Stock Fund Investment

Given that some courts have stated their position that the decision as to what to include in a SPD is a fiduciary act, incorporating the prospectus into the SPD may carry risk disproportionate to the benefit. While it is administratively simpler to combine the SPD and prospectus for a publicly traded company that includes a company stock fund investment, you may consider the following alternate approaches.

Preparing a Separate Prospectus and SPD For a Plan with a Company Stock Fund Investment

Preparing a separate SPD and company stock fund prospectus may best insulate plan fiduciaries from the type of scrutiny discussed in the cases above. While this adds administrative complexity, as some Form S-8 information already appearing in an SPD will need to be duplicated in a document that is separate from the SPD, the task should not be too arduous and should insulate plan fiduciaries, acting in that capacity, for misstatements appearing in the prospectus.

Hybrid Solution to Preparing a Prospectus for a Company Stock Fund Investment

Practitioners may be able to mitigate fiduciary risk simply by rejecting the integrated SPD/prospectus approach and the two-document approach. Instead, prepare one document that will only reflect the Form S-8 prospectus elements that are not also required in an SPD. See SEC Form S-8 Prospectus Requirements for a Company Stock Fund under Prospectus Requirements When Offering a Company Stock Fund Investment in a 401(k) Plan. The remainder of the prospectus will be set forth in the plan's SPD, ideally limited to a designated section thereof. That section or language will only address the Form S-8 requirements for a prospectus that are typically set forth in an SPD (like plan eligibility).

Indicate in the separate (non-SPD) prospectus that the designated portions of the SPD constitute part of the prospectus for the registered shares (as the prospectus can consist of one or more documents per Rule 428(b)(1)(ii)). That prospectus document, alone, will disclose that the company's SEC filings are incorporated by reference. It should not, therefore, be deemed to be an ERISA document that is subject to plan fiduciary oversight.

Include a legend on the cover of the SPD stating that specifically designates portions of the SPD to constitute part of a prospectus covering securities registered under the Securities Act (see Legend and Date Requirements for any Document (or Part of a Document) that Constitutes a Prospectus under Combining a Plan SPD with a Prospectus for a Company Stock Fund Investment). And, indicate the same legend in the applicable portion(s) of the SPD.

Related Content

Practice Notes

- Disclosure Rules for SPDs, Participant-Directed Plans, Employer Securities, and Blackout Notices
- Electronic Disclosure Rules (ERISA Safe Harbor)
- Employer Stock in Retirement Plans Resource Kit
- ERISA § 404(c) and QDIA Safe Harbors
- Form S-8 Registration Statement Drafting and Filing

Checklists

- SPD Content Requirements Chart (Retirement Plans)

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- Named Pro Bono Partnership Volunteer of the Year in 2010
- Member of the Legal Advisory Counsel for the National Association of Professional Employer Organizations, Since 2000

Barry Salkin concentrates his practice in ERISA and employee benefits law. He has significant expertise drafting, amending and negotiating various ERISA and employee benefit plans, including defined benefit pension plans, profit sharing plans, 401(k) plans, as well as qualified and non-qualified deferred compensation programs. He also has wide-ranging experience crafting group medical and health plans involving Health Care Reform, HIPAA, and COBRA. In addition, he has represented clients in ERISA litigation and audits.

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