

ERISA Section 404(c)

Employers frequently sponsor 401(k) plans to affordably attract and retain quality employees. This practical business strategy, unfortunately, cannot exist in a vacuum. When an employer adopts a 401(k) plan, the Employee Retirement Income Security Act (ERISA) of 1974 insists that the employer also accept liability to prudently select the plan's investment offerings and to foster sound participant investment decisions.

ERISA allows sponsors of 401(k) plans to make investment decisions for their employees, but most employers choose to allow their employees to do this for themselves. For many, ERISA, under its Section 404(c), offers participant investment decision liability relief. Participants in a 404(c) plan are given investment decision responsibility regardless of their investment knowledge. The plan sponsor still must prudently select the investment menus, but under 404(c), the sponsor's fiduciary liability is limited with respect to losses that arise directly from participant's investment decisions.

Complying with 404 (c) is not mandatory, but if a sponsor wants to receive the liability relief 404(c) offers, it must follow several guidelines. First, the Department of Labor (DoL) mandates participant notification that the plan is intent on being 404(c) compliant. Next, a plan must offer a "broad range" of at least three distinct core investment options. The core funds must have different risk/reward characteristics that allow participants the opportunity to diversify their accounts. It is crucial that plan fiduciaries continue monitoring and evaluating the investment lineup, effectively ensuring participants that risk/reward and performance of the core funds are meeting expectations.

It should be noted that employer stock and investments that restrict direct transfers (e.g., exchanges) cannot be used as the core investment options. In addition to these guidelines, 404(c) requires that fund transfers be allowed at least quarterly, although this requirement is seldom an issue in a daily valued 404(c) plan. Sponsors utilizing an investment professional's assistance in providing employee education may further demonstrate (visibly) their intent to comply with 404(c).

The Summary Plan Description, which is distributed to all participants, discloses the plan's intention to be 404(c) compliant. A separate document outlining the 404(c) requirements is utilized and distributed to the participants. The disclosures should be updated and distributed at least annually. Additional information, such as a fund's operating expenses or portfolio construction, also must be furnished upon participant request. It is essential that participants be given access to the most current disclosure materials prior to investing, thereby affording participants enough time to make an informed choice.

Compliance with 404(c) greatly depends on practical policies and procedures implemented and followed by the plan sponsor. Financial advisors are in an ideal position to assist sponsors in meeting their compliance goals. Compliance should not be considered a “once and done”, but rather an ongoing process. As we have stated, following 404(c) is not a requirement. Effectively, it appears to be prudent to follow 404(c), as it both potentially reduces plan sponsors’ fiduciary liability and gives their participants greater freedom over their own investment decisions.

Attached is a sample 404(c) compliance checklist that can assist in helping obtain this added layer of protection? By no means should it be the sole basis used when creating a section 404(c)-compliant program, and it should be reviewed by counsel before being implemented, as it cannot be considered tax or legal advice.

ERISA Section 404(c) Compliance Checklist

Fiduciaries of a 404(c) plan are required to provide certain information to plan participants. In addition, a fiduciary is also required to give additional information, upon request, to a plan participant. This is a sample 404(c) compliance checklist that can assist in helping obtain this added layer of protection.

Information that should be provided to plan participants:

1 . An explanation that the plan intends to comply with 404(c).

- Sample language: “The Company offers you a choice of investment alternatives for your account. The Plan is intended to constitute a plan described in 404(c) of ERISA and Title 29 of the Code of Federal Regulations Section 2550.404c-1.”

2. An explanation that plan fiduciaries may be relieved of liability.

- Sample language: “The Plan fiduciaries are relieved of any liability or losses that are the direct and necessary result of investment instruction given by any member of the Plan.”

3. A description of each investment alternative under the plan.

- Sample language: “In deciding which fund to choose, there are important factors to keep in mind. The investment objectives of each fund vary and so do the risks involved. Before selecting how you want your account invested, you should consider the level of risk you are willing to accept.”

4. Each designated investment alternative includes a general description of its objectives, its risk/return characteristics, and information regarding the type of assets in the portfolio.

- Sample language: “_____ fund attains growth through investing in _____. The _____ fund invests primarily in _____ and _____ company stocks which tend to be more volatile and less liquid than _____ company stocks. These factors can affect performance.

A prospectus contains important information about a fund, including its investment objectives, risks, charges, and ongoing expenses, which an investor should carefully consider before investing.”

5. Identification of designated investment managers.

- Sample language: “The following investment options are available in our program:
 1. Fund 1 from Manager A
 2. Fund 2 from Manager B
 3. Fund 3 from Manager C
 4. Fund 4 from Manager D
 5. Fund 5 from Manager E*

6. An explanation of the circumstances under which participants may be given investment instructions; including the limitations on such instructions, restrictions on transfers, limitation on voting rights; and information on penalties or adjustments related to fund transfers.

- Sample language: “Our plan provides for daily valuation. This means you may contact _____ during normal business hours, log on to _____ 24 hours a day or call _____ Voice Response Unit at _____ 24 hours a day to access your account and either change the direction of future investments or exchange your investment from one investment to another. You may also do both. Although you have 24-hour access to make changes to your accounts, all changes must be made by 4 p.m. EST in order to receive the current day’s pricing. Changes received after 4 p.m. will be processed during the next business day and receive the next business day’s pricing.

We encourage you to review your investment selections and request that you be sure your decisions are based on a long-term savings strategy.

There may be brief periods during the year when the Plan will not allow any participant access to his/her account. You will, of course, be notified as far in advance as possible.”

7. A description of transaction fees and expenses which will affect the participant's account.

- Sample language: “Your investment account will (not) be assessed any fees for plan administration. The mutual funds within our plan charge management expenses against the fund as a whole, not to you directly. These expenses are fully disclosed within the prospectuses and all investment returns are net of all expenses. We will make available any prospectus you request.”

8. Information on indemnification of the plan fiduciary responsible for providing information.

- Sample language: “All plan fiduciaries are bonded as required by law. In the unlikely event that plan assets are handled inappropriately, a Fidelity Bond will protect at least 10% of the plan's assets.

The fiduciaries do (not) carry separate fiduciary insurance.

9. Information regarding investments in employer securities, if any, available through the plan.

- Sample language: “Your plan does not invest any of its assets in our own securities.”

10. A copy of the most recent prospectus. (This must be provided immediately before or after investment.)

- Sample language: “A prospectus is available prior to your investment in _____ fund. If you choose to invest in the fund, a copy of the prospectus will be delivered to you.

You may contact _____ at ____ - ____ - ____ to obtain the most recent prospectus

11. After investing, participants must be provided with plan materials related to the exercise of voting, tender, or similar rights.

- Sample language: “You will be allowed to vote the shares of any fund you own should such action be necessary.”

**ADDITIONAL INFORMATION THAT MUST BE FURNISHED
TO PLAN PARTICIPANTS UPON REQUEST**

1. A description of the annual operating expenses of each designated investment alternative, including investment management fees, administrative fees, and transaction costs, if any. All of these fees reduce the participant's rate of return.
 2. Copies of prospectuses, financial statements, and reports related to the plan's designated investment alternatives.
 3. A list of assets constituting the portfolio of each designated investment alternative.
 4. The value of shares as well as past and current investment performance, net of expenses, for each available investment alternative.
 5. The value of the shares held in a particular participant's account.
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