

## PROTECTING PLAN SPONSORS FROM INVESTMENT LIABILITY WITH ERISA 404(c)

### What to know before your meeting

Business owners who sponsor retirement plans for their employees are fiduciaries. As fiduciaries, they could be held personally liable if they mismanage the plan and face civil and criminal penalties for their wrongdoing. Fortunately, there are ways to limit fiduciary investment risk, one of which is through compliance with Section 404(c) of the Employee Retirement Income Security Act of 1974 (ERISA). ERISA Sec. 404(c) provides that if the terms of a business owner's retirement plan allow participants and beneficiaries to (1) exercise control over the assets in their individual accounts, (2) invest their plan assets in a broad range of investment alternatives, and (3) receive adequate information about plan investment choices that allows them to make informed decisions, then the business owner will not be held responsible for the participants' investment decisions.

As a plan fiduciary, following the provisions of ERISA Sec. 404(c) is the only way you will be able to relieve yourself from liability for any investment losses participants may experience in their individual accounts within the plan. Consult your tax and/or legal advisors regarding your specific needs.

### Questions to review before your meeting

**Q: Am I required to comply with ERISA Sec. 404(c)?**

**A:** No, complying with ERISA Sec. 404(c) is completely voluntary. However, if you do intend to follow the provisions of ERISA Sec. 404(c), you must state your intent in your plan document and satisfy participant notice requirements.

**Q: Can you expand on the three basic requirements the plan must meet in order to be ERISA Sec. 404(c) compliant?**

**A:** With respect to participant control of assets, there are no hard and fast rules to definitively determine whether participants have independent control over the assets in their individual accounts. That determination is made based on the facts and circumstances of the situation. However, participants must have the ability to change their investment elections at least quarterly, or more frequently, in light of market volatility.

A broad range of investment alternatives is satisfied if the following three conditions are met. Participants must have the ability to:

- Materially affect the potential risk and return on their account balances
- Choose from at least three investment alternatives, each of which is diversified and has materially different risk and return characteristics
- Diversify their investment portfolios so as to minimize the risk of large losses

A plan that intends to relieve plan officials of fiduciary liability with respect to investments must inform participants of that fact. This is done by providing an annual notice and through a statement in the plan's summary plan description. Also, an ERISA Sec. 404(c) plan must give participants sufficient information about investment options under the plan so they will be able to make informed investment decisions on their own.

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### Questions to review before your meeting (cont.)

**Q: If my plan document states that the plan is ERISA Sec. 404(c) compliant, am I covered?**

**A:** Not necessarily. While the rules do require that the plan document contain a statement that the plan intends to comply with the provisions of ERISA Sec. 404(c) — if that is the intent of the plan sponsor — the true test is whether you and the plan satisfy ERISA Sec. 404(c) provisions in the actual operation of the plan. In this case, actions speak louder than words.

**Q: My 401(k) plan has auto enrollment for plan participants. Does this violate ERISA Sec. 404(c) compliance?**

**A:** In the Pension Protection Act of 2006, Congress included a “qualified default investment alternative” (QDIA) provision for plans that automatically enroll participants, the use of which would enable a plan sponsor to maintain ERISA Sec. 404(c) compliance when participants failed to give investment direction. Long term, a QDIA can take the form of a target date fund, a managed account or a balanced fund. Short term, a money market fund may be used for no more than 120 days, after which assets must be shifted to a long-term QDIA in order to continue ERISA Sec. 404(c) coverage.

### Checklist to complete before your meeting

Your financial advisor can help you determine whether you should comply with ERISA Sec. 404(c) and, if so, how you can demonstrate your compliance. Before you meet with your financial advisor, you may want to gather some important information and documents:

- Your most current plan documents
- Information and documentation related to your plan’s investment options, including your investment policy statement, if one exists
- Your plan’s investment procedures
- Service provider agreements

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