

Why Employers Need Help With 404(c)

Example:

A 65-year-old participant expects to retire at the end of the year. In November, just before a sharp market downturn, he transfers his entire account to an aggressive stock fund and incurs a heavy loss. Would he sue the plan sponsor? He might. Without 404(c), he might win.

404(c) At A Glance

Facts

- Over 73 million employees hold more than \$2.3 trillion in assets in their company 401(k) plans.
- Most of these plans give employees the opportunity to direct their own investments.
- Employers do not want exposure to lawsuits by plan participants who make poor investment decisions.
- ERISA 404(c) is a section of the Employee Retirement Income Security Act that offers protection to employers who give employees control over the investment of their accounts.
- Compliance with 404(c) is optional, but if a plan does comply, an employer generally will not be liable for losses resulting from an employee's investment decisions.

How Investment Professionals Can Help

Most employers fall into one of three categories:

- 1 They have never heard of 404(c).
- 2 They have read something about 404(c), but are not sure how it affects them.
- 3 They have examined 404(c) and believe they are in compliance or have made a conscious decision not to comply.

Employers need the assistance of an investment professional to guide them through 404(c) and help their employees make informed investment decisions.

Overview

Employers have primary responsibility for managing plan assets and are, therefore, regarded as fiduciaries. As fiduciaries, employers can help protect themselves from liability for losses resulting from employees' investment choices by taking advantage of ERISA 404(c):

- 1 ERISA 404(c) applies to 401(k), profit sharing or any other defined contribution plan that gives employees control over the investment of their accounts.

Employers that comply with 404(c) are able to shift responsibility for investment results to plan participants.

Consequences of Noncompliance

Compliance with 404(c) is optional. However, employers who fully comply with 404(c) guidelines can generally avoid liability for losses resulting from an employee's investment decisions. Failure to comply with 404(c) simply means the employer is not insulated from liability.

404(c) At A Glance

Continued

Scope of Protection

Although 404(c) generally shields plan fiduciaries from liability stemming from employees' investment decisions, fiduciaries still have the responsibility to:

- **make prudent investment alternatives available to plan participants;**
- **properly implement participant investment instructions; and**
- **avoid prohibited transactions.**

Requirements to Comply with 404(c)

While there are numerous details concerning 404(c) compliance, some of the key requirements are:

1 Employee notification

The employer must inform plan participants that they have control over their investments and that the plan intends to comply with ERISA 404(c).

2 Investment choices

The plan must offer at least three “core” investment options, each with distinctly different risk and return characteristics (such as a stock fund, bond fund and money market fund).

3 Transfer flexibility

Participants must be able to transfer money between options as frequently as the volatility of each option warrants, but no less frequently than quarterly .

4 Investment information

The employer must give participants sufficient information about their options so they can make informed investment decisions. An employer who does not supply adequate information will remain liable, even if the participant actually makes the investment decisions.

404(c) Tips

- The regulations do not endorse any specific combination of core investment options. However, participants must have the ability to invest their accounts in such a way that they can achieve any prudent point on the risk/return spectrum.
- Employers have no explicit requirement to offer a “safe” option such as a fixed interest or money market fund, though it may be difficult to meet the risk-taking objectives of every participant if the plan does not offer at least one ultra conservative option.
- Employer stock may never be a core investment option, although it could be offered in addition to the core options. At a minimum, the stock must be publicly traded with enough activity to be liquid, and participants must be able to freely transfer out.

404(c) Audit Checklist

Employers seeking 404(c) protection must answer “yes” to every question on the checklist.

- | | | |
|------------------------------|-----------------------------|--|
| <input type="checkbox"/> Yes | <input type="checkbox"/> No | 1. Does the plan allow participants to make investment decisions? |
| <input type="checkbox"/> Yes | <input type="checkbox"/> No | 2. Does the plan offer three or more investment options? |
| <input type="checkbox"/> Yes | <input type="checkbox"/> No | 3. Does the plan offer at least three “core” investment options with materially different risk and return characteristics? |
| <input type="checkbox"/> Yes | <input type="checkbox"/> No | 4. Is it possible for participants to allocate assets among the three core options in such a way that they can achieve any prudent point on the risk/return spectrum? |
| <input type="checkbox"/> Yes | <input type="checkbox"/> No | 5. Is each core option itself diversified? |
| <input type="checkbox"/> Yes | <input type="checkbox"/> No | 6. Are participants permitted to transfer into and out of each core option at least quarterly? |
| <input type="checkbox"/> Yes | <input type="checkbox"/> No | 7. Are participants permitted to transfer into and out of any option as frequently as warranted by the investment’s anticipated volatility? |
| <input type="checkbox"/> Yes | <input type="checkbox"/> No | 8. Are participants permitted to transfer into at least one core option, or into a “cash-equivalent” type fund, at least as frequently as they are permitted to transfer out of the most volatile option available? |
| <input type="checkbox"/> Yes | <input type="checkbox"/> No | 9. Is the plan free of limitations on the maximum amount or percentage a participant may invest in any core option? |
| <input type="checkbox"/> Yes | <input type="checkbox"/> No | 10. With respect to any transaction, does the participant or beneficiary exercise independent control with respect to the investment assets in their individual account? |
| <input type="checkbox"/> Yes | <input type="checkbox"/> No | 11. Is there an identified plan fiduciary who is responsible for ensuring that participants’ investment instructions are carried out? |
| <input type="checkbox"/> Yes | <input type="checkbox"/> No | 12. Does the plan give participants the option to receive written confirmation of their investment instructions? |
| <input type="checkbox"/> Yes | <input type="checkbox"/> No | 13. If expenses for carrying out investment instructions are charged to participants’ accounts, are participants periodically informed of the actual expenses charged to their accounts? |
| <input type="checkbox"/> Yes | <input type="checkbox"/> No | 14. If the plan offers employer stock as an option, does it meet the additional 404(c) requirements relating to employer securities? |

404(c) Audit Checklist

Continued

Employers seeking 404(c) protection must answer “yes” to every question on the checklist.

Yes No

15. Is the following information given to participants before they make investment decisions:

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- Notification that the plan intends to comply with 404(c) and that plan fiduciaries are not liable for any losses resulting from participants' investment instructions.
 - A description of each available investment option including its objective, risk and return characteristics, and portfolio holdings.
 - The procedures for giving investment instructions.
 - A description of any charges incurred for the purchase or sale of any investment option (e.g., sales loads, deferred sales charges, redemption or exchange fees).
 - Immediately before or after a participant's initial investment in any option, a copy of the most recent prospectus. (Subsequent prospectuses must be available upon request.)
 - If the plan passes voting rights through to participants, information describing those rights.
 - A description of the information available upon request (described below) and the fiduciary responsible for providing the information.

Yes No

16. Is the following information available to participants upon request?

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- A description of each option's annual operating expenses.
 - Prospectuses, financial statements or other materials provided to the plan relating to an investment option.
 - Each investment option's portfolio holdings, their values or percentage of the portfolio, and, for any fixed-rate insurance or bank contract, the issuer, contract term and rate of return.
 - The value of shares or units for each investment option, and past and current performance determined net of expenses.
 - The value of shares or units held in the participant's account.
 - The value of shares or units for each investment option, and past and current performance determined net of expenses.

Yes No

17. Do all answers on this checklist also apply to beneficiaries of plan participants?
