



PENSION TRENDS

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ERISA Section 404(c) Plans

Back in 2010, the Department of Labor (DOL) published participant fee disclosure regulations as part of their efforts to improve disclosure to plan participants who are permitted to direct investments in a defined contribution plan. These regulations only apply to plans that are subject to ERISA and allow participant direction of investments. (Note that a plan is considered to be participant-directed even if participants are allowed to direct the investment of only a portion of their accounts). Even though the regulations have been out for nearly a decade now, the rules are complex enough that it's worth revisiting them periodically. It's like baking a cake: Simple enough if you follow the recipe, but nearly impossible if you don't.

The Regulatory Cookbook

ERISA Section 404(c) offers a plan sponsor liability protection for investment losses resulting from the participant's direction of investments in their account; basically, a "safe harbor" for plan fiduciaries. The following discussion pertains specifically to ERISA Section 404(c)(1), which covers relief for affirmative elections made by the participants or beneficiaries and assumes that employer securities are not offered in the plan. ERISA Section 404(c)(5) is separate and pertains to relief for the absence of an affirmative investment election (Qualified Default Investment Alternative – "QDIA safe harbor").

DOL Reg. Section 2550.404c-1(b), defines an "ERISA Section 404(c) plan" as an individual account plan that provides the participant or beneficiary an opportunity (1) to exercise control over the assets in his or her individual account, and (2) to choose from a broad range of investment alternatives in which to invest his or her individual account. The participant must receive from the fiduciary (or other person(s) designated by the fiduciary) sufficient information to make

informed investment decisions, and be given reasonable opportunity and instructions regarding their elections, including written confirmation that such instructions were carried out.

An important feature of the liability protection is that any relief provided is transactional. A failure to satisfy conditions for 404(c)(1) relief for one investment transaction doesn't necessarily mean that 404(c)(1) relief isn't available for other investment transactions that do satisfy the relief conditions.

What's on the Investment Menu?

The "broad range of investments" requirement is met if the plan offers at least three investment alternatives ("core investments"), each of which is diversified and has materially different risk and return characteristics, and that together enable the participant to achieve any point on the risk/return spectrum within the range normally appropriate for the participant. The plan may impose charges for reasonable expenses of carrying out investment instructions, and must impose reasonable restrictions on the frequency with which participants may give investment instructions. The participant must have the ability to transfer among at least three of the core investments no less frequently than quarterly. The plan may include other investment options in addition to the core investments, and 404(c)(1) relief is also available to those so long as the plan meets the other conditions of 404(c)(1).

404a-5 Fee Disclosure Notice is the Main Ingredient

The rules regarding the disclosure of administrative, individual, and investment-related fees to participants are specified in DOL Reg. Section 2550.404a-5.

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Since these fee disclosures are mandatory as part of the fiduciary's general fiduciary obligations under ERISA Section 404(a), failure to comply constitutes a breach of fiduciary duty. These fee disclosures apply regardless of whether the plan is a 404(c)(1) plan. The endless details of the fee disclosures requirements are beyond the scope of this newsletter.

While satisfying the 404(c)(1) requirements is optional, it is usually advisable to take advantage of the protections it offers since, once the above-mentioned 404a-5 fee disclosures are provided, very little remains to qualify for 404(c)(1) protection. For a plan that does not offer employer securities, the only additional disclosure requirements are that the plan needs to notify participants that (1) the plan intends to comply with 404(c)(1), and (2) plan fiduciaries may be relieved of liability for any losses resulting from the participants' investment decisions. This notification is most commonly accomplished in the Summary Plan Description (SPD).

Investment Cooking Class

The fiduciary is under no obligation to provide the participant investment advice or investment education to qualify for 404(c)(1) relief. However, the latter is encouraged (see DOL Interpretive Bulletin 96-1: Participant Investment Education) since it can assist participants and beneficiaries in making informed investment decisions. The fiduciary does not have a duty to monitor the performance of an investment manager designated directly by the participant. However, the fiduciary is responsible for all aspects of plan investment selection and monitoring, including prudent selection and monitoring of any service provider made available to plan participants, since 404(c)(1) relief does not protect the fiduciary from making imprudent investment choices at the plan level.

The Investment Recipe

404(c)(1) protection is about following a process. While not legally required, an Investment Policy Statement (IPS) is a great way to document the investment selection process (why an investment was selected in the first place) and monitoring process (criteria for when an investment should be replaced). As with all aspects of qualified plan

administration, documentation of policies and procedures is key to keeping the plan in compliance. In the case of 404(c)(1) relief, this includes keeping records of all investment-related participant notices and education materials that were distributed, and attendance records for participant enrollment and education meetings. Stating the intent to comply with 404(c)(1) in the SPD and reporting the corresponding plan characteristic code on the annual Form 5500 should be supported by actions, and documentation is the best way to demonstrate that.

The frequency of plan information and investment disclosure requirements varies depending on the type of required disclosure. Participants and beneficiaries must receive plan-related information concerning the investment alternatives (i.e. - explanation of the circumstances under which investment instructions, including specified limitations, may be given), general administrative (i.e. recordkeeping) fees and individual-specific (i.e. participant loan processing) fees which may be charged directly to their account, on or before the date they are first allowed to make investment decisions, and then at least annually thereafter. Other disclosures such as additional information about each investment option must be made available upon the participant's request.

Ingredients Not Included

No fiduciary 404(c)(1) relief is available for:

- the excise taxes imposed on prohibited transactions in participant's account
- certain direct or indirect transactions with the plan sponsor or any affiliate of the sponsor
- participant loans
- transactions contrary to the documents and instruments governing the plan
- transactions that would cause the fiduciary to maintain ownership of plan assets outside the jurisdiction of the United States district courts
- transactions that would jeopardize the tax qualification status of the plan
- transactions that could result in a loss in excess of the participant's account balance

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