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# PENSION ANALYST

Update on the issues—Reporting and disclosure



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## Department of Labor rules for ERISA section 404(c) compliance

### Who's affected

These requirements apply to:

- Qualified defined contribution plans,
- ERISA 403(b) plans, and
- Voluntary employee account portions of defined benefit plans

that allow participants and beneficiaries to direct the investment of their individual accounts, and that have elected to take advantage of the fiduciary liability relief afforded under the ERISA section 404(c) regulations.

These requirements do not apply to governmental plans or to church plans that do not elect to be covered by ERISA. In addition, they do not apply to non-ERISA 403(b) plans.

### Background and summary

ERISA requires plan fiduciaries to diversify plan investments and to select investments in a prudent manner. Compliance with the requirements of ERISA section 404(c) may relieve plan fiduciaries of liability for investment losses resulting from a plan participant's or beneficiary's exercise of control over assets in his individual account and other requirements are met.

To qualify for this relief, participants and beneficiaries must have the opportunity to:

- Exercise control over assets in their individual accounts; and
- Choose, from among a broad range of investments, how their accounts will be invested.

To enable participants and beneficiaries to exercise investment control, plan sponsors must provide them with certain information about the available investments, including disclosures required under the [DOL's participant fee disclosure regulations issued in October 2010](#). This issue of the *Pension Analyst* summarizes the DOL's section 404(c) regulations as modified by the participant fee disclosure regulations. In addition, this issue identifies fiduciary obligations that are not eligible for 404(c) protection, the impacts of automatic enrollment on 404(c) protection, and Form 5500 reporting requirements for 404(c) plans.

### Action and next steps

Plan fiduciaries, with the assistance of their legal counsel, should review ERISA section 404(c) requirements to evaluate their plan's current compliance with these requirements. If you conclude that your plan currently does not meet the requirements under ERISA section 404(c), but you would like to take advantage of this protection, please contact your Prudential representative for assistance.

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Under ERISA, plan fiduciaries must diversify plan investments, and select investments prudently. Under the DOL regulations issued pursuant to ERISA section 404(c), fiduciaries will not be liable for losses resulting directly from participants' or beneficiaries' exercise of control over their accounts if the plan satisfies all of the regulations' requirements.

Generally, plan participants and beneficiaries must be able to:

- *Exercise control* over assets in their individual accounts; and
- Choose, from among a *broad range of investments*, how their accounts will be invested.

A plan that meets these requirements, as discussed more fully below, is an ERISA section 404(c) plan.

**Exercise of control requirement**

Exercise of control exists when participants and beneficiaries have a reasonable opportunity to give investment instructions to an identified plan fiduciary who must carry them out. Investment instructions that are not in writing (e.g., oral) must be confirmed in writing. A fiduciary may hire a third party service provider, such as Prudential, to carry out these instructions wherever it is prudent to do so.

Exercise of control also exists when plan fiduciaries make default investments for participants and beneficiaries according to the [DOL safe harbor rules for default investments](#), effective December 24, 2007. If a plan chooses not to comply with these default investment rules, the plan fiduciaries retain liability for the default investment of those funds.

In very limited circumstances, a plan fiduciary may ignore a participant's investment instruction (for example, if it would result in a prohibited transaction or generate taxable income for the plan).

The participant's or beneficiary's exercise of control must be independent of outside influence. For example, a plan fiduciary should not conceal material facts or accept instructions from a participant or beneficiary known to be legally incompetent. The facts of each case determine if control is independent.

In addition, special [disclosure rules](#) require fiduciaries to provide specific information to participants and beneficiaries about the plan and the available investment alternatives.

## Broad range of investments requirement

A broad range of investments exists when there is a reasonable opportunity for a participant or beneficiary to:

- Materially affect the potential return in his individual account;
- Materially affect the degree of risk the account is subject to;
- Choose from at least three diversified core investment categories; and
- Diversify so that the portion of the account that the participant controls has minimum risk of large or inordinate losses.

The core investment categories must contain investment choices that have materially different risk and return characteristics, and must enable participants to achieve portfolios with risk and return characteristics that are normal and appropriate. The regulations do not require specific types of investment options, but employer stock does not qualify as a core investment.

The core investment categories must permit investment instruction at least once within every three-month period, or more frequently as appropriate in light of the market volatility of the investment. In addition, one of the three core investment categories must accept transfers as often as they may be made out of any available investment in the plan. Alternatively, the plan sponsor can provide a low risk fund or sub-fund as a transfer vehicle.

## Disclosure rules

To comply with ERISA section 404(c), the following information must be furnished to participants and beneficiaries:

- Notice that the plan is intended to be a 404(c) plan and that plan fiduciaries may be relieved of liability for certain losses.
- Disclosures required under the [participant fee disclosure regulations under ERISA section 404\(a\)](#).
- If employer stock is offered as an investment alternative under the plan, a description of the confidentiality procedures for information relating to the purchase, holding and sale of employer stock, and the exercise of voting, tender and similar rights, by participants and beneficiaries, and the name, address, and phone number of the plan fiduciary responsible for monitoring compliance with the confidentiality procedures.

## Other fiduciary obligations

While compliance with the section 404(c) rules may relieve plan fiduciaries of certain liability for losses resulting from investment decisions made by participants and beneficiaries, it does not relieve them of *all* fiduciary responsibilities concerning plan investments. Fiduciaries must still prudently select the investment alternatives made available to participants and beneficiaries and monitor the investment performance of these selections.

## Impacts of automatic enrollment

If a 401(k) plan provides for automatic enrollment, it necessarily provides a default investment vehicle for those contributions that are made without specific direction from the employees. These default investments have 404(c) protection only if the plan complies with the [DOL safe harbor rules for default investments](#). If the plan does not comply with these rules, plan fiduciaries are responsible for the investment of the participant's account in the default investment.

## Form 5500 reporting

The Form 5500 explicitly asks whether the plan or any portion of the plan is intended to comply with 404(c). This indicator is provided in item 8a. Because the Form 5500 is signed under penalty of perjury, there are potentially serious consequences if the fiduciary cannot support the representation that the plan is intended to qualify as an ERISA section 404(c) plan.

## Next steps

Plan fiduciaries who wish to take advantage of 404(c) protection should, with the assistance of legal counsel, review the requirements discussed above to determine if their plan's current plan design, disclosures and trading procedures meet ERISA section 404(c) requirements. If you determine that your plan currently does not meet the requirements of ERISA section 404(c), but you would like to take advantage of some of the materials and services Prudential offers to help plans achieve 404(c) compliance please contact your Prudential Retirement representative.

### **Pension Analyst by Prudential Retirement**

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