

# *Pension* ANALYST

Update on the Issues

Reporting and Disclosure

July 2008



## Department of Labor Requirements For Participant-Directed Investments

**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 chosen to take advantage of the fiduciary liability protection afforded by 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) programs.

**BACKGROUND AND SUMMARY** ERISA requires plan fiduciaries to diversify plan investments and to choose investments in a prudent manner. ERISA section 404(c) relieves plan fiduciaries of liability for investment losses when a plan participant or beneficiary exercises independent control over the investment of his individual account. If a plan meets the section 404(c) requirements, plan fiduciaries will not be liable for any loss that is a result of the participant's or beneficiary's investment direction.

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 this investment control, plan sponsors must provide them with certain information about the available investments. These requirements are commonly referred to as the disclosure rules.

This issue of the *Pension Analyst* summarizes the Department of Labor's (DOL) section 404(c) regulations and describes the participant disclosure rules that must be satisfied to obtain 404(c) protection. In addition, it identifies fiduciary obligations that are not eligible for 404(c) protection, impacts of automatic enrollment on 404(c) protection, and Form 5500 reporting requirements for 404(c) plans.

**ACTION AND NEXT STEPS** Plan fiduciaries that wish to have 404(c) protection should review these requirements to determine if they are being met. If you conclude that your plan is currently not protected 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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**RELATED DOCUMENT**

- [ERISA Section 404\(c\) Disclosure Items](#)

**Basic ERISA Section 404(c) Requirements**

Under ERISA, plan fiduciaries must diversify plan investments, and choose 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 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.

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 may *not* be one of the core investments.

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 subfund as a transfer vehicle.

### **Disclosure Rules**

The regulations require plan sponsors to automatically provide participants and beneficiaries with certain information. Plan sponsors must make other information available upon request.

Some of the information that *must* be furnished to participants and beneficiaries includes:

- Notice that the plan is intended to be a 404(c) plan and that plan fiduciaries may be relieved of liability for certain losses.
- Description of each investment option, including its investment objectives and risk and return characteristics.
- Explanation of how investment instructions can be given and any related restrictions.

Special disclosure rules apply to employer stock investments, which may need to have certain confidentiality procedures in place.

The following information may be provided either directly or only *upon request*:

- Description of annual operating expenses for each investment option.
- Copy of prospectuses, financial statements, or any other material related to the investment options provided under the plan.
- List of assets comprising the investment portfolio and the value of those assets. (Note: The Pension Protection Act of 2006 (PPA) generally requires participant-directed defined contribution plans to provide participant benefit statements to participants and beneficiaries quarterly.)
- The value of the shares in each investment option, including past and current investment performance.
- The value of the shares held in each participant's account.

Much of this disclosure information is available in materials and services that Prudential offers, such as Summary Plan Description (SPD) booklets, Participant Benefit Statements, [the Prudential Online Retirement Center](#), [Plan Sponsor Website](#), Retirement Workbooks, and the [Prudential Retirement Education and Planning Website](#). The [ERISA Section 404\(c\) Disclosure Items](#) chart lists required disclosure items and indicates where this information may be located, and includes suggestions for how it can be delivered. Even though much of this disclosure information is provided in Prudential materials and services, you still need to review it, determine how best to disclose some types of information for your plan and inform your participants about the availability of this information and how to locate it.

If you would like additional information regarding any of these materials or services, please visit our home page at <http://www.prudential.com/> or our Prudential Retirement Education and Planning Website or contact your Prudential Retirement representative.

Technically speaking, plan fiduciaries are not required to educate participants and beneficiaries about investment options. Rather, participants and beneficiaries must receive enough information to make meaningful investment decisions. Therefore, plan sponsors must provide the relevant information *before* investment instructions are given.

### **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.

The Prudential Due Diligence Advisor Program® was developed to help fiduciaries to choose and monitor plan investment alternatives. This program is an unbiased examination of Prudential's investment offering that provides a method to evaluate, select and monitor all of the funds that we offer retirement plans. Our primary objective is to ensure that risk and return standards and manager attributes remain consistent with investment objectives and that plan sponsors receive substantive data to allow them to make informed decisions.

If you would like more information about the Prudential Due Diligence Advisor Program® and how it can help you, contact your Prudential representative.

### **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 is explicit in asking 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.

If Prudential provides Form 5500 services for your plan, you will need to tell us how to answer this question before we can complete the Form for your signature.

### **Next Steps**

Plan fiduciaries who want to take advantage of 404(c) protection should review the requirements discussed above to determine if their current plan design and disclosure and trading procedures enable the plan to take advantage of ERISA section 404(c). If you determine that your plan is currently not protected under ERISA section 404(c), but you would like to take advantage of some of the materials and services that Prudential offers to help your plan achieve this protection, visit any of the previously noted links or contact your Prudential Retirement representative.

If you do not want to take advantage of 404(c) protection, you do not need to take any action.

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