

REQUIREMENTS FOR COMPLIANCE WITH ERISA SECTION 404(c) REGARDING PARTICIPANT DIRECTED ACCOUNTS

I. What are the requirements under ERISA section 404(c)?

To qualify for the protections under ERISA section 404(c), a plan must meet the following requirements:

- (a) **Individual Account Plan:** The plan must be an individual account plan. An individual account plan is a plan that maintains separate accounts for each participant. Under the plan, benefits are based solely on the amount contributed to the participant's account, and any income, expenses, gains, losses, and any forfeitures of accounts of other participants which may be allocated to the participant's account.
- (b) **Opportunity to Exercise Control:** The right to self-direct participant accounts must be specifically authorized under the terms of the plan. Participants and beneficiaries must have the right to give instructions (in either written, electronic, or telegraphic mode) and have the option to receive written confirmation of the instructions from the plan fiduciary. The plan sponsor or plan administrator must identify a fiduciary who is responsible for carrying out the participant's directions.
- (c) **Broad Range of Investment Alternatives:** The plan must offer a broad range of investment options to participants and beneficiaries. The plan will be considered to have offered a broad range of investments if each participant and beneficiary has a reasonable opportunity to:
 - (1) materially affect both the potential return and degree of risk relating to his or her account;
 - (2) choose from at least three "core" investment alternatives – each of which is diversified and satisfies certain other requirements; and
 - (3) diversify his or her investment to minimize the risk of large losses.

II. What are the conditions for complying with ERISA section 404(c) exercise and control requirements?

A fiduciary will only be entitled to the protection offered by section 404(c) if the participant actually exercises independent control over the assets in the participant's individual account. The following rules apply:

- (a) **Absence of Affirmative Instructions:** A plan fiduciary will not be relieved of responsibility for investment decisions unless those decisions have affirmatively been made by the participant. If a participant does not provide affirmative instructions, the fiduciaries remain responsible for prudently investing those assets and will remain personally liable for any losses that occur as a result of failing to exercise their fiduciary duties.
- (b) **Independent Control:** Whether a participant has exercised independent control is determined on a facts and circumstances basis. The regulations specify the following

situations in which a participant will not be considered to have exercised independent control:

- (1) The participant is subject to improper influence by the plan fiduciary or sponsor with respect to the transaction.
 - (2) A plan fiduciary has concealed from the participant material, nonpublic facts regarding the investment.
 - (3) The plan fiduciary knowingly accepts investment instructions from a participant whom the fiduciary knows to be legally incompetent.
- (c) **Disclosure Requirements:** The participant must be given sufficient information to make informed investment decisions. A plan fiduciary who does not supply participants with adequate investment information will remain liable, even if the participant actually makes an investment decision. It is not sufficient that the fiduciary provide the participant with a referral for obtaining information. Rather, the fiduciary must ensure the participants have basic information concerning the investment alternatives under the plan. Participants must be given a sufficient amount of information as well as sufficient time to make informed investment decisions and to exercise the rights incident to the ownership of those assets. The information requirements are divided into two categories. The first category is information that is required to be furnished automatically to participants. The second category is information that is required to be provided to participants only upon request.
- (1) **Information required to be furnished automatically to participants:**
 - (A) **Notice of Limited Liability:** An explanation that the plan is an ERISA section 404(c) plan and that the plan fiduciaries may be relieved of liability for any losses that result from the participant's investment instructions.
 - (B) **Description of All Investment Alternatives:** A description of all investment alternatives available under the plan, including a general description of the investment objectives of each alternative, the risk and return rates of each alternative, and the diversification of assets within each alternative.
 - (C) **Identification of Investment Managers:** If a plan does not limit the investment alternatives available to participants and allows participants to invest in any asset administratively feasible for the plan to hold, a general statement to that effect will be a sufficient description. If the plan allows participants to choose from one or more designated investment managers, the designated investment managers must be identified.

- (D) **Investment Instructions and Restrictions:** An explanation of the circumstances under which a participant may give investment instructions, including to whom, when, and how instructions may be made. The explanation must also include any limitations which apply to those instructions.
 - (E) **Transaction Fees:** A description of all transaction fees, charges, or expenses which may be charged to or affect a participant's account.
 - (F) **Provider of Information:** The name, address, and telephone number of the plan fiduciary responsible for providing additional information available upon request, and a general description of the information and documents which may be obtained upon request.
 - (G) **Confidentiality Procedures:** If employer securities are offered as an investment alternative, a description of established procedures designed to provide for the confidentiality of information concerning the purchase, holding, and sale of employer securities.
 - (H) **Prospectuses:** Participants must automatically receive, immediately following a participant's initial investment in an investment alternative subject to the Securities Act of 1933, a copy of the most recent prospectus furnished to the plan. A plan need not provide the participant with a copy of every prospectus which it receives after the participant invests in an alternative subject to the Securities Act. However, the plan must maintain copies of the prospectuses for participants to review upon request.
 - (I) **“Pass-Through” Proxy Materials:** Participants must automatically receive, after an investment, any materials which are provided to the plan that relate to the exercise of voting, tender, or similar rights which are passed through to participants. If ownership rights are not passed through, the fiduciary will not receive section 404(c) protection for the exercise of those rights.
- (2) **Information that must be supplied upon request:** The following information must be maintained and furnished to participants upon request:
- (A) **Financial Reports:** Copies of any prospectuses, financial statements and reports, and any other material received by the plan which relate to each investment alternative.
 - (B) **Operating Expenses:** A narrative description of the annual operating expenses of each designated investment alternative (including, for example, investment management fees, administrative fees, transaction costs, and other costs which reduce a participant's rate of return). In addition, a fiduciary must calculate the sum of the operating expenses expressed as a percentage of the average net assets in that particular investment alternative.

- (C) **List of Assets:** A list of the assets that comprise the portfolio of each designated investment alternative that is a “plan asset” under DOL Reg. §2510.3-101 as well as the value of each asset.
 - (D) **Overall Investment Performance:** Information concerning the value of shares of units in an investment alternative available to participants, as well as past and current investment performance of each investment alternative. Investment performance must be reported as “net of expenses, on a reasonable and consistent basis,” taking into consideration the nature of the asset.
 - (E) **Individualized Investment Performance:** Information concerning the value of shares or units held in the individual account of a participant in a particular investment alternative.
- (3) **Timing of Disclosure:** In general, a participant must be furnished with required information before he or she is permitted to give investment instructions or exercise ownership rights. Subsequent information which describes material changes to an investment alternative must be supplied to participants in sufficient time to enable participants to consider the changes and make investment decisions in light of them.
- (d) **Broad Range of Investment Alternatives:** To satisfy the broad range of investment alternatives requirement, a participant must be given the opportunity to materially affect the potential return on, and degree of risk to, the assets in his or her account. At a minimum, a participant must be able to choose from among at least three investment alternatives referred to as “core investment alternatives.”
- (e) **Frequent Opportunity to Give Investment Instructions:** To ensure that participants are actually exercising control over the assets in their account, they must be given frequent opportunity to alter the composition of their individual portfolios by moving the assets in their account among the different available investment vehicles.
- (1) **Volatility Requirement:** Participants must be permitted to transfer the assets in their accounts with sufficient frequency to minimize loss. Therefore, they must be afforded the opportunity to give investment instructions with a frequency that is appropriate in light of the volatility of the market.
 - (2) **Three-Month Rule:** A plan may impose reasonable restrictions on the frequency with which investment instructions may be given and accepted. However, to qualify under section 404(c), a participant must have at least one opportunity within every three-month period to give investment instructions for each core investment alternative.

- (3) **Volatility Investment Transferability Rule:** If, due to the volatility of the market, a participant is allowed to give investment instructions and transfer assets out of any investment alternative more than once within a three month period, either one of the core investments or a low risk cash equity fund must accept the transfer of those assets with the same frequency.

III. How Do I Get Additional Information?

For additional information regarding ERISA section 404(c) compliance, please contact us at:

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