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Is Your Plan in "Compliance"? Participant direction and 404(c)

Why allow participants to direct their own investments?

The primary goal is to allow them to customize their own investments around their personal needs, time horizon, and risk tolerance. The secondary goal is to mitigate some of the risk that the fiduciaries of the plan have for the investment performance. Both of these goals are important and most 401(k) plans today are set up using the participant direction model. This piece discusses the second of these goals.

What is the Fiduciary standard in the first place?

The fiduciary for a plan is required to act **"prudently."** This generally means that the plan should have a procedure in place to select and monitor the investments of the plan and the plan should follow that procedure. This procedure is usually referred to as an Investment Policy Statement (IPS). A fiduciary does not have to guarantee positive investment returns, but needs to be attentive and follow a reasonable process for evaluating them.

What is 404(c) Protection?

It is an affirmative defense that a fiduciary can raise as protection against a law suit. It is a legal shield. The standards are contained in ERISA Section 404(c) of the law and the regulations issued thereunder.

How does a plan satisfy the 404(c) rules?

A full explanation is outside the scope of this piece, but here are the general requirements:

- *Information and Disclosure* - You must inform your participants of your intention to comply with 404(c) and must provide them with a description of all fees and investment alternatives available to them
- *Investments* - The investment structure must provide a "broad range of alternatives". This includes at least 3 alternatives that are diversified, have materially different risk and return characteristics, allows a participant to achieve appropriate returns for the level of risk
- *Diversification* - Participants must be able to diversify across the available alternatives
- *Administration* - Participants must be given the opportunity and ability to change investments at an appropriate frequency

If I don't follow the 404(c) guidelines, is my whole plan out of "Compliance"?

No. ***404(c) compliance is NOT a legal requirement for your plan***. If you don't follow the 404(c) guidelines then you don't get the protections of 404(c). It's that simple. Does that leave you more exposed as a fiduciary than if you did meet the guidelines? Yes, of course, since you don't have that legal shield. However, it is important to note that you still have the general fiduciary guidelines to protect you, and they are relatively easy to meet as mentioned above.

What does Limestone recommend?

First - Don't panic when someone claims your plan is out of "compliance." Call us. Second, if you are going to offer participant direction, then it certainly makes sense to try and get 404(c) protection. Virtually all 401(k) platform providers have designed their systems to help you meet the 404(c) requirements. This is one of the reasons that we strongly support the use of these platforms. If your plan offers individual brokerage accounts to participants, you are most likely NOT fully complying with 404(c) due to the notice requirements. The legal guidance in this area is not well developed. If you have questions about your particular arrangement, please contact us.

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