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PRACTICAL INSIGHTS

Practical Insights: Individual Account Pension Plans - Shifting Fiduciary Risk of Loss

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Problem:

Fiduciaries of individual account pension plans, such as §401(k) plans, can be held liable for losses in an individual participant's or beneficiary's account. This potential liability presents an unacceptable risk to the trustees and plan administrators of these plans, especially when the plan is "self-directed," *i.e.,* the individual account holder exercises control over the assets.

How can a fiduciary shift the risk of loss caused by a participant's or beneficiary's exercise of control over the assets in their account?

Solution:

A fiduciary can shift the risk of loss in an individual account plan to the participant or beneficiary, if the plan meets the requirements of an ERISA §404(c) plan. As interpreted by the United States Department of Labor ("DOL"), the federal agency with jurisdiction over ERISA issues, the most significant requirements, among others, are as follows:

1. The terms of the plan must give the participant or beneficiary a reasonable opportunity to give investment instructions to an identified plan fiduciary who is, in general, obligated to comply with such instructions.

2. The participant or beneficiary must be provided or given the opportunity to obtain sufficient information to make informed decisions about available investment alternatives and incidents of ownership accompanying such investments.

3. The participant or beneficiary must be provided: (i) an explanation that the plan is intended to constitute a 404(c) plan and that the fiduciaries of the plan may be relieved of liability for any losses which are the direct and necessary result of investment instructions given by such participant or beneficiary; (ii) a description of the available investment alternatives and a general description of the investment objectives and risk and return characteristics of each such alternative, including information relating to the type and diversification of assets comprising the portfolio of the designed investment alternative; and (iii) an explanation of the circumstances under which participants and beneficiaries may give investment instructions and an explanation of any specified limitations on such instructions under the terms of the plan, including any restrictions on transfer to or from a designated investment

alternative, and any restrictions on the exercise of voting, tender and similar rights that accompany a participant's or beneficiary's investment in an investment alternative. If your company's individual account plan is intended to be a 404(c) plan, periodically check the plan's compliance which Section 404(c) before a DOL audit occurs or a fiduciary breach claim is made.