

Compliance Advisory

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Participant Investing in Governmental Defined Contribution Plans

By now, most plan sponsors have heard of “Section 404(c)” and the protection it provides. Fiduciaries of retirement plans subject to ERISA may seek protection under Section 404(c) for losses suffered by plan participants as a result of unwise investment decisions. Unfortunately, this Section 404(c) fiduciary protection is not available to you, as the sponsor of a governmental plan, if participants look to you for compensation as a result of losses in their retirement accounts. However, there may be steps you can take to reduce your liability in this respect.

Government employers often use the principles prescribed by ERISA as guidelines for the operation of their retirement plans since state courts often look to ERISA for guidance when interpreting fiduciary matters. In addition, some states have actually adopted Section 404(c)-type requirements. For example, California has enacted a statute that adopts ERISA’s Section 404(c) principles under California Government Code section 53213.5(b). It provides the plan trustee and local agency sponsoring the plan with relief of responsibility under the terms of the plan and trust for participant-directed investments. The relief is conditioned upon communication and education requirements similar to those found in Section 404(c) of ERISA.

Other governmental plan sponsors can use ERISA 404(c) as a blueprint to mitigate the risk to plan fiduciaries for participants who choose their own investments. The following highlights the guiding principles of ERISA Section 404(c):

- Participants have the opportunity to *exercise control* over investments in their accounts and actually exercise this control.
- Participants have the opportunity to:
 - Choose from a *broad range of investment alternatives*,
 - Give investment instructions with appropriate frequency in light of market volatility and investment alternatives offered, and
 - Obtain sufficient information to make informed investment decisions, including historical return rates and fees charged.

Following these principles not only gives plan sponsors the basis for relief from liability with respect to investment decisions made by plan participants, it also ensures that participants receive the communication and educational information they need to make well-informed decisions. It would be in everyone’s best interest if participants’ investment goals were met, which in turn allowed them to enjoy a secure retirement.

To assist you in following the principles outlined under Section 404(c), we have developed a checklist for you to review and use to enhance your plan’s investment policies and communication/education initiatives.

Checklist for Governmental Plan Sponsors

Plan Design

- A written investment policy statement exists and is updated regularly.
- The Plan offers three or more funds that are diversified and have different risk/return characteristics in order to enable participants to minimize risk through diversification and achieve aggregate risk and return appropriate for their specific situations
- An individual(s) has been designated as the person responsible for accepting investment instructions and for complying with such instructions. Participants are able to receive written confirmation of investment instructions.
- Participants are able to make investment changes at least quarterly. The appropriate investment change frequency should be based on the market volatility of the investments offered.

Participant Disclosure – to be provided automatically

- An explanation of how participants may provide investment instructions and any limitations (e.g. frequency, fees, restrictions, etc). This includes restrictions on the exercise of voting, tender, and similar rights if voting rights are passed on to participants.
- A description of each investment option, including investment objectives and risk / return characteristics. In the case of “look-through investments,” such as pooled separate accounts, the descriptions should include the type and diversification of assets making up the underlying portfolio.
- Identification of designated investment managers (if any).
- Disclosure of transaction fees and expenses charged to participant accounts.
- Notification of the name, address, and phone number of the person responsible for providing plan information that is available upon request. This notice includes a description of the information available.
- A prospectus for any investment option that is a registered security (i.e, subject to the Securities Act of 1933), to be provided immediately before or after a participant’s initial investment in that option.
- An explanation that the plan sponsor may be relieved of liability with respect to any loss resulting from investment instructions given by participants.

Participant Disclosure – to be provided upon request

- A description of the annual operating expenses of each investment option that affects the participant's rate of return.
- A description of the total annual operating expenses of each investment alternative, expressed as a percentage of average net assets in the investment.
- Copies of any prospectuses, financial statements, reports, and materials relating to each investment option that are provided to the plan.
- A listing of assets comprising the portfolio of each investment option which are themselves "plan assets" (as opposed to the underlying assets relating to a registered security which are not themselves "plan assets"), the value of such assets (or the proportion of the investment option which it comprises), and, in the case of assets which are fixed rate investment contracts issued by a bank, savings and loan association or insurance company, the name of the issuer of the contract, the term of the contract and the rate of return on the contract.
- Information on share or unit values in the participant's own account.
- Information on share or unit values in available investment options and past and current investment performance (net of expenses) of available investment options.

Prudential Retirement can assist you in providing many of the items on this checklist. If you have questions or would like to discuss how Prudential Retirement can partner with you to evaluate and enhance your plan, please contact your Prudential Retirement representative.

Compliance Advisory by Prudential Retirement

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