

MEMO# 2283

October 22, 1990

STATUS OF ERISA SECTION 404(C)

- 1 - October 22, 1990 TO: PENSION COMMITTEE NO. 25-90 RE: STATUS OF ERISA SECTION 404(c) _____

As we discussed at the last Pension Committee meeting, Institute staff and representatives from individual fund sponsors met with Assistant Secretary David Ball on October 16, 1990 regarding the status of the Department of Labor regulation under ERISA section 404(c). At the meeting, Mr. Ball stated that the Department of Labor intends to repropose its regulation under section 404(c) before the end of this year. However, the regulation will be substantially different from both the version proposed in 1987 and version "leaked" to various members of the financial services industry earlier this year (hereinafter referred to as the "Spring Regulation"). As you recall, ERISA section 404(c) provides that the fiduciaries of individual account retirement plans are not liable for investment losses if they provide participants the opportunity to control the investment of their individual accounts. In 1987, the proposed regulation under section 404(c) (the "1987 Regulation") generally would have required a 404(c) plan to contain four investment options from which participants could choose: A cash fund, an equity fund, a bond fund and a balanced fund. There was some uncertainty as to whether the cash fund could also serve as a "safe" fund for purposes of the regulation or whether the 404(c) plan actually needed a fifth fund which would hold accounts of employees who made no investment choices. The Spring Regulation would have required a 404(c) plan to contain three investment options: A cash fund, an equity fund and a bond fund. The "safe" fund concept was eliminated because 404(c) plan protections would not apply to accounts of employees who failed to make investment decisions. Both the 1987 and the Spring Regulations would have required unrestricted quarterly transfers among investment options. Neither regulation allowed employer stock investments to be covered by section 404(c).

- 2 - At our meeting, Mr. Ball expressed his intention to re-propose the regulation in a form that would not provide any certainty to employers as to whether their plans meet the requirements of section 404(c). Instead, the regulation would generally state that an ERISA section 404(c) plan must provide participants with "a broad range of investment options", ample diversification within the investment choices and reasonable "control" over the investments, i.e., frequency of transfer. Mr. Ball stated that the Department of Labor is still considering providing a "safe-harbor" for participant directed investments in employer stock under section 404(c). The re-proposed regulation probably would state that two investment options do not provide a "broad range of investment alternatives", although it would not state that three options are sufficient. The regulation should also explain that a plan will not satisfy section 404(c) if the investment options offered have the same general investment objective, e.g., a plan is not a section 404(c) plan if its only investment options are three stock funds. However, the regulation is expected to be less clear about which options are necessary. Mr. Ball stated that he wanted the marketplace to determine the parameters of a section 404(c) plan. Thus, he did not want the regulation to be a snapshot of participant directed plans in 1990.

Rather, the regulation is meant to evolve with pension industry standards, products and technology. For example, as more self-directed plans offer daily switching among investment options, daily exchanges will be the standard by which an ERISA section 404(c) plan will be judged. Likewise, it is possible that participants will not be considered to have a sufficiently broad range of investment options available to them in the future if they cannot invest in an international or global fund. According to Mr. Ball, the Department of Labor will not issue advisory opinions to employers who request rulings regarding their plans' compliance with ERISA section 404(c). Mr. Ball stated that employers will have to obtain such guidance from their counsel and from any judicial opinions which arise out of section 404(c) litigation. He also indicated that the regulation proposed in 1987 should be useful to employers and the courts in determining the Department of Labor's position regarding section 404(c). If the Department of Labor repropose the regulation as described above, it does not appear that it will be necessary for mutual fund companies to vigorously support the regulation in the manner we discussed at the Pension Committee meeting because the regulation will be non-controversial. However, the Institute will provide suggestions to the Department of Labor regarding the manner by which the re-proposed regulation should describe a - 3 - "broad range of investment choices" and other matters. If you have any comments in this regard, please call me at 202/955-3516 as soon as possible. We will keep you informed of further developments. W. Richard Mason Assistant General Counsel

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