INVESTMENT COMPANY INSTITUTE

MEMO# 17114

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DOL GUIDANCE ON MARKET TIMING IN RETIREMENT PLANS AND RELATED ISSUES

[17114] February 18, 2004 TO: PENSION MEMBERS No. 14-04 PENSION OPERATIONS ADVISORY COMMITTEE No. 15-04 RE: DOL GUIDANCE ON MARKET TIMING IN RETIREMENT PLANS AND RELATED ISSUES The Department of Labor has issued guidance designed to assist plan fiduciaries in responding to market timing by participants in pension plans. As suggested by the Institute in a letter to the Department,1 the guidance clarifies the availability of relief under ERISA section 404(c) where steps are taken to address identified market timing problems. Specifically, the Statement issued by Assistant Secretary Ann Combs provides two examples of approaches to limit market timing activity that do not, in and of themselves, violate the "volatility" and other requirements set forth in the Department's section 404(c) regulations. The first example is the imposition of reasonable redemption fees on sales of shares of a mutual fund or a similar investment; the second is a "reasonable plan or investment fund" limitation on the number of times a participant can move in and out of a particular investment within a particular period. Section 404(c) relief remains available, in the two examples, provided that such restrictions are allowed under the terms of the plan and clearly disclosed to plan participants and beneficiaries.2 In addition, the Statement provides general guidance for plan fiduciaries in light of recent late trading and market timing investigations.3 The Statement emphasizes that ERISA requires fiduciaries to discharge their duties prudently. Thus, fiduciaries, through a deliberative process, must make decisions that are as well informed as possible under the 1 See Institute Memorandum to Pension Members No. 3-04 and Pension Operations Advisory Committee No. 4-04 (16983), dated January 22, 2004. 2 The Statement notes, however, that the imposition of trading restrictions that are not contemplated under the terms of the plan raises issues concerning the application of section 404(c) and whether such restrictions give rise to a "blackout period" requiring advance notice to affected participants and beneficiaries. See Institute Memorandum to Pension Members No. 5-03 and Pension Operations Advisory Committee No. 5-03 (15585), dated January 24, 2003. 3 See, e.g., October 16, 2003 Remarks of Assistant Secretary Ann L. Combs, available at http://www.dol.gov/ebsa/newsroom/sp101603.html, in which similar statements were made concerning the fiduciary duties involved in the selection of investment options under ERISA. 2 circumstances in determining whether to make any changes in mutual fund investments or investment options. Where government agencies have identified specific funds under investigation, the Statement provides that the following factors should be considered by fiduciaries: (1) the nature of the alleged abuses, (2) the potential economic impact of those abuses on plan investments, (3) the steps taken by the fund to limit the potential for such abuses in the future, and (4) any remedial action taken or contemplated to make investors

whole. The Statement recommends that fiduciaries consider contacting the fund directly to the extent that such information has not been provided. In determining whether to participate in settlements or lawsuits, a fiduciary should weigh the costs to the plan against the likelihood and amount of potential recoveries. The Statement also provides that, because late trading and market timing abuses may extend to mutual funds and pooled investments beyond those currently identified by Federal and state regulators, plan fiduciaries must consider whether they have sufficient information to conclude whether such funds have procedures and safeguards in place to limit their vulnerability to abuse. The appropriate course of action will depend on the particular facts and circumstances relating to a plan's investment in a fund. In general, plan fiduciaries should seek to act reasonably, prudently and solely in the interests of participants and beneficiaries, following prudent plan procedures with respect to investment decisions and documenting such decisions Finally, in a press release relating to the Department's guidance, Assistant Secretary Combs announced that the Employee Benefits Security Administration is conducting reviews of mutual funds, similar pooled investment funds and service providers to such funds to determine whether there have been any violations of ERISA. Thomas T. Kim Associate Counsel Attachments (in .pdf format) Note: Not all recipients receive the attachments. To obtain copies of the attachments, please visit our members website (http://members.ici.org) and search for memo 17114, or call the ICI Library at (202) 326-8304 and request the attachments for memo 17114.