COMPLIANCE UNDER ERISA SECTION 404(C) WITH INCREASING INVESTMENT ALTERNATIVES AND ACCOUNT ACCESSIBILITY

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INTRODUCTION

A common feature of today's retirement plans, especially the increasingly popular 401(k) plans,[1] is a provision for plan participants to direct the investment of assets in their accounts.[2] The number of investment options available to participants has increased, probably due to both technology and industry demand.[3] While it seems advantageous to the participants in retirement plans to have the opportunity to direct their investments, it could lead to risks for both plan participants and the employers who sponsor such plans. The risk to participants is the investment risk that accompanies investment control. The risk to plan sponsors is fiduciary liability for investment losses if they do not meet all of the requirements of section 404(c) of the Employee Retirement Income Security Act of 1974 ("ERISA").[4]

While participants and plan sponsors may view their individual risks differently, they are not completely distinct. The risks derive from a determination of who is liable for losses in participants' account balances due to investment performance. If the plan complies with the requirements of ERISA section 404(c) and the underlying Department of Labor ("DOL") regulations, the plan sponsor obtains relief from liability for losses to participants' accounts and the plan participants bear the investment risk. If the sponsor maintains a participant-directed account plan, the sponsor should follow the rules set forth by ERISA section 404(c). However, this is not necessarily a simple task. The requirements of ERISA section 404(c) are extremely complex and may be difficult if not impossible to meet in plans which offer a large number of investment alternatives. The increasing use of automated telephone systems and computers as a form of communication may also make it difficult for plan sponsors to comply with some of the requirements of ERISA section 404(c).

This Note analyzes the requirements of ERISA section 404(c) and assesses the compliance difficulties facing plans that offer a large number of investment alternatives and/or automated interaction by plan participants. The risks to participants in such plans are analyzed by reviewing the original purpose of

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1. *See, e.g.*, John Collins, *Watch Out for Hidden Risks in 401(k) Plans*, DALLAS BUS. J., May 23, 1997, at 12B.

2. *See* 26 U.S.C. § 401(k) (1994 & Supp. II 1996); Interpretive Bulletins Relating to the Employee Retirement Income Security Act of 1974 (ERISA) [hereinafter *Interpretive Bulletins*], 29 C.F.R. § 2509.96-1 (1998).

3. *Interpretive Bulletins*, 29 C.F.R. § 2509.96-1 (1998).

4. ERISA § 404(c), 29 U.S.C. § 1104(c) (1994 & Supp. II 1996).

ERISA to determine if current regulations and practices are promoting that purpose. Finally, this Note proposes changes to the ERISA regulations and DOL enforcement practices to better promote the interests of both plan participants and plan sponsors.

The changes most likely to occur with respect to participant-directed plans are adjustments to the notice, election, and disclosure requirements of ERISA and the Internal Revenue Code to accommodate the use of new technologies in plan administration. The Taxpayer Relief Act of 1997 ("the Act")[5] calls for the Secretary of Labor to interpret the existing requirements to allow for the use of current technology while protecting the rights of participants and beneficiaries in such plans.[6] The interpretive regulations called for by the Act are due to be published by the Secretary no later than December 31, 1998.[7]

I. COMPLIANCE UNDER ERISA SECTION 404(C)

Congress enacted ERISA in 1974 to regulate the private pension system. ERISA sets disclosure and reporting requirements for retirement plan sponsors

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5. Taxpayer Relief Act of 1997 § 1510(a), Pub. L. No. 105-34, 111 Stat. 788, 1068-69 (1997).

6. *Id.* § 1510(a), 111 Stat. at 1068-69.

7. *Id.* at 1068. The Secretary of Labor published proposed regulations and invited public comments on the use of electronic communication and recordkeeping technologies by employee benefit plans on January 28, 1999. Use of Electronic Communication and Recordkeeping Technologies by Employee Pension and Welfare Benefit Plans, 64 Fed. Reg. 4506 (1999) (to be codified at 29 C.F.R. pt. 2520) (proposed Jan. 28, 1999). The proposed regulations set forth a safe harbor for delivering required disclosures via electronic media. *Id.* at 4507. Because the guidance is in the form of a safe harbor, plan administrators may rely on the proposed provisions when utilizing electronic delivery, but the proposed regulations are not the only means that may be used by a plan administrator using electronic delivery. *Id.*

The proposed regulations allow a plan administrator to utilize electronic items but include provisions to ensure participants receive the items in a form they can use. Under the safe harbor electronic disclosure provisions, the plan administrator must: (1) take steps to ensure actual receipt by participants; (2) conform to ERISA's style, format, and content requirements; (3) notify the participants of the importance of the electronic documents to be furnished; and (4) provide a paper copy of the document if the participant so requests. *See id.* at 4512. As a further safeguard, the participants must be able to access the electronic documents and print them at the participant's worksites. *See id.*

The proposed regulations are intended to apply to most required disclosure items of employee benefit plans. However, the precise scope is unclear because at least one type of disclosure item will not be able to be provided electronically. *See* Colleen T. Congel, *Pensions: Plans Should Continue to Provide Safe Harbor Notices on Paper, Official Says* [1999] DAILY TAX REP. (BNA), No. 57, at G-6 (Mar. 25, 1999). An IRS official has indicated that participant notices required by 401(k) plans that are intended to meet nondiscrimination safe harbors must continue to be given on paper. *See id.* Therefore, further clarification of the scope of the proposed regulations will be required.

and sets standards of conduct for plan fiduciaries.[8] ERISA also sets standards for vesting of accrued benefits, minimum funding requirements, and termination of retirement plans.[9] The underlying purpose of ERISA, however, is "to protect and strengthen the rights of employees, to enforce strict fiduciary standards, and to encourage the development of private retirement plans."[10]

Section 404(c) of ERISA and the underlying DOL regulations specifically apply to plans that allow participants or beneficiaries to control the assets in their individual accounts.[11] If plan sponsors comply with section 404(c), then they enjoy relief from liability due to losses in participant accounts from the participant's investment control.[12] While this section purports to give relief to plan sponsors, the sponsor will only receive the indicated relief by complying with the complex requirements governing selection of investment alternatives and disclosure of information to participants and beneficiaries. The stringent standards protect the interests of participants and beneficiaries while allowing them the freedom to control the investment of assets in their individual accounts. If plan sponsors could not obtain relief from losses due to a participant's or beneficiary's asset direction, the sponsors would have little incentive to implement a plan which allowed for participant-directed accounts.

Before looking at the specific requirements of section 404(c), it may be helpful to identify who is eligible for its relief. Liability relief pertains to plan fiduciaries.[13] The plan sponsor is one such fiduciary and is the focus of this Note. The plan may specifically name other parties as plan fiduciaries, such as a plan administrator or investment managers. Third parties may obtain fiduciary status by exercising a certain degree of control over investment decisions relating to the plan assets.[14] Section 404(c) applies to these other fiduciaries in the same manner as it does to plan sponsors; however, the language of section 404(c) specifically states that plan participants and beneficiaries do not become plan fiduciaries by exercising control over the investment of assets in their accounts.[15] As a result, plan participants and beneficiaries need not worry about the liability that may result from a fiduciary breach simply because they exercise control over the assets in their own account.

ERISA section 404(c) applies to plans that allow participant-directed investments. It provides liability relief to plan sponsors from investment losses incurred by participants and beneficiaries who give investment direction. However, the requirements of ERISA and the DOL regulations that apply to

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8. ERISA § 1(b), 29 U.S.C. § 1001(b) (1994).

9. 29 U.S.C. § 1001(c) (1994).

10. *See In re* Unisys Sav. Plan Litig., 74 F.3d 420, 434 (3d Cir. 1996) (citing ERISA § 1, 29 U.S.C. § 1001; H.R. REP. NO. 93-533 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4639, 4639-43).

11. 29 U.S.C. § 1104(c) (1994 & Supp. II 1996); Rules and Regulations for Fiduciary Responsibility, 29 C.F.R. § 2550.404c-1(a)(1) (1998).

12. *See* 29 U.S.C. § 1104(c)(1)(B) (Supp. II 1996).

13. *See id.*; *see also id.* § 1002(21)(A) (1994) (defining plan fiduciary).

14. *See id.* § 1002(21)(A).

15. *Id.* § 1104(c)(1)(A) (Supp. II 1996).

section 404(c) must be met before relief is provided. An examination of the requirements should clarify how this section protects participants and beneficiaries as well as plan sponsors who implement participant-directed plans.

A. Opportunity to Exercise Control

The first requirement a plan must satisfy in order to obtain the fiduciary relief of section 404(c) is that the plan must offer the participants or beneficiaries the opportunity to exercise control over the assets in their individual accounts.[16] The DOL regulations set forth two criteria to be met before a participant or beneficiary is deemed to have the opportunity to exercise control over his or her assets.[17] First, the participant must have the opportunity to give instructions to an identified plan fiduciary who is obligated to comply with those instructions.[18] To satisfy this requirement, the participant or beneficiary must be given the opportunity to receive written confirmation of the instructions.[19] If an electronic medium is utilized in completing transactions, then the plan fiduciaries must ensure that they still give participants and beneficiaries the opportunity to receive the confirmation in writing, not electronically, or the plan fiduciaries may risk noncompliance.

The Taxpayer Relief Act of 1997 addresses ERISA compliance and the use of new technologies.[20] The Act calls for DOL regulations[21] clarifying the types of paperless transactions which will satisfy the writing requirements under the Internal Revenue Code, but it fails to address the writing requirements of ERISA.[22] If the DOL regulations do not include an interpretation of ERISA's writing requirements as well as those of the Internal Revenue Code, plan fiduciaries should be careful not to overlook this written confirmation requirement.

The second part of the opportunity to exercise control is the provision that each participant or beneficiary have the "opportunity to obtain sufficient information to make informed decisions with regard to investment alternatives available under the plan, and incidents of ownership appurtenant to such investments."[23] The regulations list many disclosure items, some of which must be given automatically by the plan fiduciaries and others that must be given only

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16. 29 C.F.R. § 2550.404c-1(b)(1)(i) (1998).
17. *Id.* § 2250.404c-1(b)(2)(i).
18. *Id.* § 2550.404c-1(b)(2)(i)(A).
19. *Id.*
20. Taxpayer Relief Act of 1997 § 1510(a)(1), Pub. L. No. 105-34, 111 Stat. 788, 1068 (1997).
21. *See supra* note 7.
22. *Id.* The Act calls for regulations from the Secretary of Labor interpreting notice, election, consent, disclosure, and time requirements of both the Internal Revenue Code and ERISA in section 1510(a)(1), but only the writing requirements of the Internal Revenue Code are referenced for interpretation. *Id.*
23. 29 C.F.R. § 2550.404c-1(b)(2)(i)(B) (1998).

upon request by a participant or beneficiary.[24] Among the automatic disclosures are: (i) limitations on when instructions may be given or transfers between investment alternatives may be made; (ii) identification of fiduciaries responsible for providing information on the investment alternatives to the plan participants and beneficiaries; (iii) risk and return characteristics of the different investment alternatives; (iv) applicable transaction fees; and (v) provision of a prospectus to a participant or beneficiary making an initial investment in a given investment alternative.[25] Items that must be disclosed upon request by a participant or beneficiary include: (i) a description of the operating expenses of the different investment alternatives; (ii) copies of prospectuses not required to be provided automatically; (iii) a list of assets which make up the portfolio of each investment alternative; and (iv) information about the value of shares or units of the different investment alternatives.[26]

In providing any of the disclosure items discussed above, plan fiduciaries owe a duty of loyalty and prudence to plan participants and beneficiaries from which they receive no liability relief under ERISA section 404(c) in the event of a fiduciary breach.[27] The court in *In re Unisys Savings Plan Litigation* identified this duty by holding that "a fiduciary may not materially mislead those to whom [fiduciary] duties of loyalty and prudence are owed."[28] The court then clarified that plan fiduciaries owe a duty of loyalty and prudence to plan participants by stating that "[a] plan administrator may not make affirmative material misrepresentations to plan participants" and "when a plan administrator speaks, it must speak truthfully."[29] Ultimately the court in *Unisys* remanded the case to the district court to resolve questions of fact surrounding the alleged misrepresentations.[30] Nevertheless, the standards set by the court make it clear that fiduciaries owe a duty of loyalty and prudence when providing information about the investment alternatives available to plan participants.

B. Broad Range of Investment Alternatives

In addition to allowing participants and beneficiaries the opportunity to exercise control over their accounts, the plan must offer meaningful investment alternatives from which the participants and beneficiaries may choose. Thus, the participants and beneficiaries must be allowed to choose from a broad range of investment alternatives.[31] The broad range requirement is satisfied only upon

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24. *Id.* § 2550.404c(b)(2)(i)(B)(l)(i)-(viii).

25. *Id.*

26. *Id.* § 2550.404c-1(b)(2)(i)(B)(2)(i)-(v).

27. *See In re* Unisys Sav. Plan Litig., 74 F.3d 420, 440 (3d Cir. 1996); ERISA § 401(a), 29 U.S.C. 1104(a) (1994).

28. *Unisys*, 74 F.3d at 440-41 (citations omitted).

29. *Id.* at 441 (quoting Fischer v. Philadelphia Elec. Co., 994 F.2d 130, 135 (3d Cir. 1993)).

30. *Id.* at 448.

31. *See* 29 C.F.R. § 2550.404c-1(b)(1)(ii) (1998).

fulfillment of three conditions.[32]

The first condition is that the investment alternatives provided allow the participant or beneficiary to have a material effect on the potential return from the amounts in his or her account.[33] The alternatives must also allow a participant or beneficiary to materially affect the degree of risk to which the invested amounts are subject.[34] This condition implies that the investment alternatives offered by the plan must present a wide range of risk and return characteristics. Only with such diverse risk and return characteristics would a participant or beneficiary be able to have a material effect on these aspects of his or her account by selecting from the different investment alternatives offered.

The second condition to the broad range requirement is that the plan provide at least three investment alternatives that have the following characteristics:

> (1) each alternative must be diversified;
> (2) each alternative must have materially different risk and return characteristics;
> (3) the alternatives must, when taken together, allow the participant or beneficiary to achieve a portfolio with risk and return characteristics at any point within a range that would be considered appropriate for the participant or beneficiary; and
> (4) each alternative, when combined with investments from the other alternatives, must tend to minimize through diversification the overall risk to the participant's or beneficiary's portfolio.[35]

Any retirement plan that offers only a few carefully picked investment alternatives must ensure that the offered alternatives meet the above requirements. If a plan offers a large number of investment alternatives, it will likely have adequately diversified alternatives with a wide range of risk and return characteristics. However, characteristics (1) and (4) above apply to *each* investment alternative. These requirements cannot be satisfied by simply offering a large number of investment alternatives. Rather, offering a large number of investment alternatives will increase the likelihood that these diversification requirements will not be satisfied. In any event, each alternative that is offered by a plan should be reviewed independently to determine if it is sufficiently diversified to meet the above criteria. This type of independent evaluation is not likely to occur if a plan offers a virtually unlimited number of

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32. *Id.* § 2550.404c-1(b)(3)(i).

33. *Id.* § 2550.404c-1(b)(3)(i)(A). The reference in the text to the participant's account appears to assume that a plan subject to ERISA section 404(c) always allows a participant or beneficiary to control the investments of his or her entire account. This assumption is not true. A plan subject to ERISA section 404(c) may allow participants or beneficiaries to control all or only a portion of the assets in their accounts. The distinction is omitted here for simplicity and because it is not important for the purposes of this Note.

34. *Id.*

35. *Id.* §§ 2550.404c-1(b)(3)(i)(B)(1)-(4).

investment alternatives,[36] which may be the case if the plan has a large mutual fund broker as an investment provider. Offering investment alternatives without proper evaluation puts the plan at risk of noncompliance and exposes the plan fiduciaries to the risk of liability for any investment losses to participant or beneficiary accounts.

The third condition to be satisfied in meeting the broad range of investments requirement is that the participants and beneficiaries must have the opportunity to diversify their accounts to minimize the risk of large losses, taking into account the nature of the plan and the size of the accounts involved.[37] In *Unisys*, the court addressed the question of how to determine whether this duty to diversify is satisfied in a given situation. The court looked to a congressional committee report that characterized the duty as one not to invest in "one type of security or in various types of securities dependent upon the success of one enterprise or upon conditions in one locality, since the effect is to increase the risk of large losses."[38]

The committee report quoted by the court spoke of the duty in terms of what the fiduciary should consider when *investing* plan assets rather than in selecting investments from which participants and beneficiaries could choose. The duty would presumably be the same for a fiduciary selecting investment alternatives for a participant-directed account plan because that was the type of plan involved in *Unisys*. The court further stated that the duty could not be quantitatively determined, but must be based on the facts and circumstances of each case.[39] The court then listed seven factors which should be considered in determining when the duty to diversify has been met.[40] The factors relate to the purpose and size of the plan, the nature and location of the employer's business, and the type of investment under consideration.[41] The court's discussion of these factors suggests that appropriately diversified investment alternatives may vary from one plan to another. Again, it appears that offering an extremely large number of investment alternatives creates a substantial burden on the plan fiduciaries if the plan is to comply with ERISA section 404(c). This burden, as with all fund selection criteria, most likely extends beyond fund selection.[42] Fiduciaries must monitor the investment alternatives to ensure that the selected alternatives remain

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36. *See, e.g.*, Thomas R. Hoecker & Nancy K. Campbell, *Participant Directed Investment Plans-Problems and Solutions, in* FIDUCIARY RESPONSIBILITY ISSUES UNDER ERISA—1996, Q245 A.L.I.-A.B.A. 211, 213.

37. 29 C.F.R. § 2550.404c-1(b)(3)(i)(C) (1998).

38. *In re* Unisys Sav. Plan Litig., 74 F.3d 420, 438 (3d Cir. 1996) (quoting H.R. REP. NO. 93-1280 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5085).

39. *Id.*

40. *Id.* The factors set forth in H.R. Rep. No. 93-1280 recognized by the court are: "(1) the purposes of the plan; (2) the amount of the plan assets; (3) financial and industrial conditions; (4) the type of investment, whether mortgages, bonds or shares of stock or otherwise; (5) distribution as to geographic location; (6) distribution as to industries; [and] (7) the dates of maturity." *Id.*

41. *See id.*

42. *See* Collins, *supra* note 1.

prudent.[43] Compliance under these criteria may be very difficult for a plan offering a large number of investment alternatives.

While the DOL regulations impose many disclosure burdens on plan fiduciaries, no obligation to provide investment advice is contained in the regulations.[44] In fact, giving too much advice could lead to additional liability by excluding transactions from the protection offered by section 404(c).[45] ERISA conveys fiduciary status to anyone who "renders investment advice for a fee or other compensation."[46] Because section 404(c) explicitly states plan fiduciaries have no obligation to give investment advice, there has been some concern that giving too much investment advice could lead to fiduciary liability not exempted by section 404(c).[47] However, the DOL addressed the situation by issuing guidance in 1996 distinguishing between "investment advice,"[48] which would not be protected by the section 404(c) liability exemption and "investment education," which would allow fiduciaries to stay within the exemption.[49]

The distinction between investment "advice" and "education" depends on the facts and circumstances of each case.[50] While an analysis of where the line between "advice" and "education" should be drawn is beyond the scope of this Note, the distinction is based on the specificity of the information provided. Information about specific investments or giving recommendations is considered investment "advice"[51] while general information about available investment alternatives or general investment concepts (including interactive materials such as worksheets and questionnaires) are considered investment "education."[52]

Although the DOL interpretive bulletin provides some useful guidance about the types of information that a plan sponsor or investment provider could safely provide to the plan participants and beneficiaries, fiduciaries still have no *obligation* to provide any guidance to plan participants and beneficiaries regarding the investment of their retirement funds.[53] Presuming the majority of plan participants and beneficiaries have no training in investing or financial markets, requiring only disclosure of information such as risk and return characteristics and past performance of the investment alternatives along with a prospectus seems inadequate preparation for decisions that could have a substantial effect on the accumulation of a plan participant's retirement assets or

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43. *See id.*

44. Rules and Regulations for Fiduciary Responsibility, 29 C.F.R. § 2550.404c-1(c)(4) (1998).

45. *See* Joe Horton, *Walking the Fine Line of Employee Financial Advice*, AUSTIN BUS. J., Mar. 14, 1997.

46. ERISA § 3(21)(A)(ii), 29 U.S.C. § 1002(21)(A)(ii) (1994).

47. *Interpretive Bulletins*, 29 C.F.R. § 2509.96-1(b) (1998).

48. *Id.* § 2509.96-1(c).

49. *Id.* § 2509.96-1(d).

50. *See id.* § 2509.96-1(c).

51. *Id.*

52. *Id.* § 2509.96-1(d).

53. *Id.* § 2509.96-1(b) n.1.

a beneficiary's income.

C. Independent Control in Fact

If a plan allows its participants and beneficiaries the opportunity to exercise control over their accounts and offers a broad range of investments as described in the previous two sections, the plan qualifies as an "ERISA section 404(c) Plan."[54] However, plan fiduciaries will receive liability relief under section 404(c) only if the participant or beneficiary has actually exercised independent control over the assets in his or her account.[55] Because relief from liability depends on the actions of individual participants, fiduciaries obtain relief on a participant-by-participant basis. The result for plan fiduciaries is that section 404(c) protection may be precluded on a plan-wide basis by not complying with the opportunity to exercise the control requirement and the broad range of investments requirement discussed above, but may only secure the protective relief with respect to each individual participant separately. In fact, a closer reading of the regulations suggests that relief is provided on a transactional basis rather than a participant basis.[56]

Whether a participant or beneficiary has actually exercised independent control over a given *transaction* is determined by the facts and circumstances of each case.[57] The use of the word "transaction" in the DOL regulation further suggests that fiduciary liability relief is determined on a transaction-by-transaction basis.

While the regulations do not clearly indicate when a participant or beneficiary has exercised independent control, they do offer some guidance as to when independent control has *not* been exercised.[58] The exercise of control is not independent if (1) the participant or beneficiary is subject to improper influence by a plan fiduciary, (2) the plan fiduciary has concealed material facts regarding the particular investment, or (3) the participant or beneficiary is legally incompetent and the fiduciary accepting the instructions knows of the incompetence.[59]

If the participant or beneficiary exercises independent control over the assets in his or her account, as mentioned earlier, the participant or beneficiary does not become a fiduciary.[60] However, the exercise of control by a participant or beneficiary alone does not provide the plan fiduciaries with relief from liability with respect to investment performance of the participant's or beneficiary's assets. The other requirements of ERISA section 404(c) must also be met. The

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54. Rules and Regulations for Fiduciary Responsibility, 29 C.F.R. § 2550.404c-1(b)(1) (1998).

55. *See id.* § 2550.404c-1(c)(1)(i).

56. *Id.* § 2550.404c-1(c)(2).

57. *Id.*

58. *Id.*

59. *Id.* §§ 2250.404c-1(c)(2)(i)-(iii).

60. *See id.* § 2550.404c-1(d)(1).

Third Circuit addressed this issue in *Unisys* as did a district court in *Conner v. Mid South Insurance Agency*.[61] Although neither court was able to apply the final regulations due to the timing of the transactions involved,[62] both courts concluded that actual independent control by a participant is not an absolute defense to a claim of fiduciary breach resulting in losses to the participant's account.[63]

In *Unisys*, the plan sponsor argued that actual control by the participants (plaintiffs) over their assets was an absolute defense to the claim of a breach of fiduciary duty resulting in losses to the participants' accounts.[64] The court held that the fiduciary protection given by ERISA section 404(c) would not be afforded to the plan fiduciaries if the disclosure regarding the investment alternatives in question was insufficient.[65] The court reasoned that insufficient disclosure would preclude the participants from exercising actual control over their investment decisions.[66] The court struck down Unisys' claim that investment direction by participants created an absolute liability shield for the plan fiduciaries for losses due to poor investment performance in the participants' accounts.[67]

In *Conner*, the court also held that the plan fiduciaries were not insulated from liability for their fiduciary breaches simply because a participant exercised control over the assets in his account.[68] As in *Unisys*, the events at issue occurred before the issuance of the final DOL regulations pertaining to ERISA section 404(c), so the court had only the language of ERISA to control the decision.[69] The court determined that some disclosure about the plan and the investment alternatives offered must be provided to plan participants before the plan fiduciaries may obtain the ERISA section 404(c) liability protection.[70] In finding no disclosure about fiduciary liability exemption or descriptions of the investment alternatives offered by the plan, the court held that the plan "[did] not fit into the scope of the exemption as it would have been commonly understood at the time of the [investment elections]" and, therefore, "[t]he Mid South plan's fiduciaries [were] not entitled to its protection."[71]

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61. Conner v. Mid S. Ins. Agency, 943 F. Supp. 647, 659 (W.D. La. 1995).

62. In each case, the events that gave rise to the litigation occurred before the DOL regulations for section 404(c) were issued. *In re* Unisys Sav. Plan Litig., 74 F.3d 420, 444 n.21 (3d Cir. 1996); *Conner*, 943 F. Supp. at 659.

63. *Unisys*, 74 F.3d at 447; *Conner*, 943 F. Supp. at 659.

64. *Unisys*, 74 F.3d at 444-45.

65. *Id.* at 447.

66. *Id.* at 447-48.

67. *Id.*

68. Conner v. Mid S. Ins. Agency, 943 F. Supp. 647, 659-60 (W.D. La. 1995).

69. *Id.* at 659. However, the court acknowledged using the regulations for guidance in interpreting certain terms contained in the statutory language such as to "exercise" and "control." *Id.*

70. *Id.* at 660.

71. *Id.*

Although few cases address the issue,[72] the propositions of the above cases, derived from the statutory language of ERISA, seem to be in accord with the DOL regulations. Participants and beneficiaries must be allowed the opportunity to exercise control over the assets in their accounts and actually exercise independent control before the fiduciary relief offered by section 404(c) will be extended to plan fiduciaries. The exercise of some asset direction by a participant or beneficiary does not provide an absolute defense to a claim of investment loss in a participant's or beneficiary's account.

II. POTENTIAL COMPLIANCE PROBLEMS

A. Disclosure and Fund Selection

Today, plan sponsors are offering an increased number of investment alternatives to participants and beneficiaries in participant-directed account plans.[73] This increase is facilitated by the use of computers and other forms of automated data transfer, which make it possible for plan sponsors to offer more investment alternatives for little additional cost. Another factor fueling the trend is that plan participants and beneficiaries are likely to view an increase in the number of investment alternatives as a benefit. Therefore, plan sponsors view the additional investment alternatives as a low cost enhancement to their plan, whether it is an existing plan or newly adopted. However, the value of offering additional investment alternatives may be less than perceived if the result is exposure to additional fiduciary liability for the plan sponsor or other plan fiduciaries.

Fiduciaries' exposure to liability may be increased by a violation of the disclosure requirements of ERISA section 404(c).[74] Some of the automatic disclosure items required by the regulations include a description of *each* investment alternative along with its risk and return characteristics and the type of assets comprising the portfolio.[75] Also required is a description of any transaction fees or expenses which may be incurred in connection with buying or selling interests in different investment alternatives.[76] If a large number of investment alternatives are offered by a plan, the volume of automatic disclosure items would create a significant burden on the plan sponsor. The likelihood that a plan sponsor will meet this burden decreases as the number of investment alternatives increases.

The plan sponsor may frequently rely on a contract investment provider, such as a mutual fund broker or insurance company, to handle disclosure of

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72. *See id.* at 659 n.12.

73. *See Interpretive Bulletins*, 29 C.F.R. § 2509.96-1 (1998).

74. *See* Rules and Regulations for Fiduciary Responsibility, 29 C.F.R. §§ 2550.404c-1(b)(2)(i)(B)(1) & (2) (1998).

75. *Id.* § 2550.404c-1(b)(2)(i)(B)(1)(ii).

76. *Id.* § 2550.404c-1(b)(2)(i)(B)(1)(v).

investment information.[77] However, while many contract investment providers may state that their services qualify the plan for liability protection under ERISA section 404(c), the investment providers will rarely assume fiduciary duties under the plan.[78] The ultimate responsibility for providing the required disclosure materials lies with the plan sponsor or other plan fiduciaries.[79]

In addition to the fund descriptions and fee information, a prospectus for each investment alternative must be provided when a participant or beneficiary makes an initial deposit into an investment alternative.[80] Timely providing the required prospectuses may lead to a situation similar to that of the other automatic disclosure items. Prospectuses are commonly distributed by the contract investment provider, but again the ultimate responsibility for providing the required prospectuses lies with the plan sponsor or other fiduciaries wishing to obtain the section 404(c) liability protection. If transactions are completed by computer or telephone, tracking the transactions to determine when a prospectus is required[81] becomes a rather complex task. A fund provider is likely to be in the best position to complete this task.[82] Plan sponsors must then be aware of the potential fiduciary liability that exists for providing disclosure so that they may properly negotiate with third parties who provide services for their plans and take appropriate measures to manage the liability.

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77. *See* Collins, *supra* note 1.

78. *See id.*

79. *See* 29 C.F.R. § 2550.404c-1(b)(2)(i)(B)(1). The disclosure information must be provided by an identified plan fiduciary or a person designated to act on his behalf. While the contract investment provider may be designated to act on behalf of the plan fiduciary, the provider does not attain fiduciary status by so acting. Because the plan fiduciary is attempting to obtain liability protection under the statute, the fiduciary must ensure that all requirements for compliance are met. *Id.*

80. *Id.* § 2550.404c-1(b)(2)(i)(B)(1)(viii). This requirement is also satisfied if a prospectus is given to the participant or beneficiary before the initial investment in an alternative is made. The prospectus may be given before an initial investment is made if either the plan sponsor provides a prospectus for all alternatives initially or if the participant has previously requested and received the prospectus pursuant to section 2550.404c-1(b)(2)(i)(B)(2)(ii).

81. As previously discussed, a prospectus is required whenever a participant or beneficiary makes an initial investment in any investment alternative (i.e., an alternative in which that participant or beneficiary has not previously made an investment) or whenever one is requested by a participant or beneficiary. 29 C.F.R. § 2550.404c-1(b)(2)(i)(B)(1)(viii) (1998). It could be a fairly complex task to monitor all transactions and determine which constitute an initial investment. A plan sponsor almost certainly will have to rely on a contract fund provider or contract third party administration firm for this tracking. However, because neither fund providers nor third party administration firms typically assume fiduciary roles, the plan sponsor will likely retain the risk of exposure to fiduciary liability for these activities.

82. The vast majority of plan sponsors will not be willing or able to install and maintain an automated response system, whether accessed by computer, telephone, or both, that can process and track participant transactions. A fund provider or other third party service provider can more efficiently maintain such a system that will serve multiple plans.

A contract fund provider also may offer to select the funds that will serve as the investment alternatives for the participants and beneficiaries simply by allowing investment into all of the funds handled by the provider.[83] As with the disclosure materials, however, the contract fund provider generally assumes no fiduciary responsibility for the selection.[84] The plan sponsor may not even realize that the selection of investment alternatives carries with it significant fiduciary liability.[85]

In addition to selecting funds, the plan sponsor or other designated fiduciary has an obligation to monitor the investment alternatives to ensure that they remain prudent.[86] Each investment alternative must meet the diversification and risk and return requirements of the DOL regulations.[87] Events may occur, such as the fund being invested contrary to its stated objective and investment style, that would render the investment an imprudent alternative, giving rise to potential fiduciary liability and a concurrent loss of section 404(c) protection.[88]

The plan sponsor must ensure that prudence is used to select and monitor the investment alternatives made available under the plan. The plan sponsor may accomplish this by assuming the responsibility or contracting with a professional advisor or trust company who is willing to take on the fiduciary responsibilities.[89] If the plan sponsor simply relies on a contract fund provider, who has no fiduciary responsibility, to select and monitor the available alternatives, the sponsor may have significant exposure to fiduciary liability for the contract provider's actions.[90]

B. Liability Resulting from Noncompliance

Violating the requirements of ERISA section 404(c) and the DOL regulations results in a breach of fiduciary duty.[91] Therefore, the parties involved with any ERISA plan must understand who the plan fiduciaries are and what duties are associated with fiduciary status. Certain plan fiduciaries, such as the plan sponsor and trustee(s), are fairly easy to determine because they are named in the plan. However, other parties may also acquire fiduciary status by their actions. ERISA section 3(21) and the underlying DOL regulations define the acts that can lead to fiduciary status.[92]

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83. *See* Collins, *supra* note 1.
84. *See id.*
85. *See id.*
86. *See id.*
87. *See* Rules and Regulations for Fiduciary Responsibility, 29 C.F.R. § 2250.404c-1(b)(3) (1998).
88. *See* Collins, *supra* note 1.
89. *See id.*
90. *See id.*
91. *See id.*
92. 29 U.S.C. § 1002(21) (1994); Definition of Terms, 29 C.F.R. §§ 2510.3-21(c)-(e) (1998).

Any person can become a fiduciary to the extent that the person (1) exercises any discretionary authority or control over the management of the plan or disposition of its assets, (2) gives investment advice or has authority to give such advice with respect to plan assets, or (3) has any discretionary authority or responsibility in the administration of the plan.[93] Persons who have any discretionary authority with respect to any aspect of the plan or its assets should be aware that they may have attained fiduciary status. However, exactly what constitutes investment advice seems less clear.

Recognizing the need for further guidance, the DOL issued regulations attempting to clarify what constitutes investment advice, both generally and specifically, with respect to ERISA section 404(c) plans.[94] In general, two conditions must be satisfied before a person is considered to have given investment advice.[95] First, the person must "render . . . advice to the plan as to the value of securities or other property, or make . . . recommendation[s] as to the advisability of investing in, purchasing, or selling securities or other property."[96] Virtually any advice concerning investment in specific assets would appear to fall within the scope of this condition. The second condition is satisfied if either (1) the type of advice described by the first condition above is given on a regular basis or pursuant to a mutual agreement or understanding, or (2) the person has discretionary authority to buy or sell assets for the plan.[97]

The interpretive bulletin issued by the DOL in 1996 further clarifies the first condition as it applies to participant-directed plans. It attempts to distinguish which types of information given to plan participants and beneficiaries constitute investment advice, giving rise to fiduciary status, from information that constitutes only investment education, which does not confer fiduciary status.[98] In defining investment advice, the interpretive bulletin follows the definition given in the previously issued regulations and simply restates it to apply specifically to situations involving the advising of participants and beneficiaries.[99]

The interpretive bulletin, however, gives some meaningful direction concerning the types of information that constitute investment education which may be provided by plan sponsors or contract fund providers to participants and beneficiaries without imposing additional liability.[100] Under the provisions of the

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93. 29 U.S.C. § 1002(21)(A) (1994).

94. 29 C.F.R. § 2510.3-21 (1998); *Interpretive Bulletins*, 29 C.F.R. § 2509.96-1 (1998).

95. *Id.* § 2510.3-21(c)(1).

96. *Id.* § 2510.3-21(c)(1)(i).

97. *Id.* § 2510.3-21(c)(1)(ii).

98. *Id.* § 2509.96-1(b).

99. *Id.* § 2509.96-1(c). The definition of investment advice in the interpretive bulletin mirrors that of the earlier issued 29 C.F.R. § 2510.3-21(c)(1).

100. *Id.* § 2509.96-1(d). Additional liability includes lack of ERISA section 404(c) protection for plan fiduciaries and the establishment of fiduciary status for a contract fund provider or other person who was not otherwise a plan fiduciary before such "advice" is given. *Id.* § 2509.96-1(b).

bulletin, the types of information which constitute investment education, *not* investment advice, are:

> (1) General information about the benefits of plan participation and general information about the investment alternatives available under the plan, including risk and return characteristics, historical return information, and prospectuses.[101] The information may not pertain to a particular investment or a particular participant or beneficiary.[102]
> (2) Information about general investment concepts, differences between asset classes such as equities and bonds, estimating future needs (including accounting for inflation), and assessing risk.[103]
> (3) Charts or graphs based on generally accepted investment theories as long as they are available to all participants and beneficiaries and disclose all facts and assumptions on which they are based.[104]
> (4) Interactive materials such as worksheets, questionnaires, or software that is based on generally accepted investment theories as long as all facts and assumptions utilized are either disclosed or supplied by the participant or beneficiary.[105]

The above is meant to be a guide and is not an exhaustive list.[106] The determination of what constitutes investment advice and what constitutes investment education is based on the facts and circumstances of each case.[107]

After determining fiduciary status based on the above "discretion" and "investment advice" criteria, a fiduciary should understand the duties required by ERISA to avoid liability for breach of those duties. ERISA requires that fiduciaries meet a "prudent man" standard of care.[108] Adhering to the "prudent man" standard, a plan fiduciary must act solely in the interest of plan participants and beneficiaries for the exclusive purpose of providing benefits to participants and beneficiaries while providing for payment of reasonable expenses of the plan.[109] Additionally, while acting solely in the interest of the participants and beneficiaries, a fiduciary must act with the care, skill, prudence, and diligence under the circumstances of a prudent man acting in a like capacity by diversifying the investments of the plan to reduce the risk of large losses.[110]

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101. *Id.* § 2509.96-1(d)(1).

102. *Id.*

103. *Id.* § 2509.96-1(d)(2).

104. *Interpretive Bulletins*, 29 C.F.R. § 2509.96-1(d)(3) (1998).

105. *Id.* § 2509.96-1(d)(4).

106. *See id.* § 2509.96-1(d).

107. *See id.* § 2509.96-1(c). While some uncertainty inevitably accompanies the "facts and circumstances" standard for satisfying any condition, the regulations seem to draw a discernable line between general information about investing and investments and information pertaining to a specific participant or the advisability of investing in a specific alternative. *See id.* § 2509.96-1(d).

108. ERISA § 401(a), 29 U.S.C. § 1104(a) (1994).

109. 29 U.S.C. § 1104(a)(1) (1994).

110. *See id.* §§ 1104(a)(1)(B) & (C).

However, the fiduciary's actions should still follow the documents and instruments of the plan.[111] A fiduciary not meeting the standards of ERISA section 401(a) may be held personally liable for losses arising from such a breach, including losses to participants' or beneficiaries' accounts in which the participants or beneficiaries exercise control over the investment of the assets in those accounts.[112]

The requirement that a fiduciary act "solely in the interest of the participants and beneficiaries" does not mean that all issues of interpretation must be resolved in favor of the participant or beneficiary.[113] The fiduciary must also follow the documents and instruments governing the plan in discharging its duties.[114] Otherwise, plan participants and beneficiaries would be encouraged to challenge all benefit determinations and any other fiduciary act affecting their account balances or eligibility for benefits. Such encouragement would be inefficient for the administration of retirement plans and the judicial system.

All fiduciary decisions are subject to the prudence standard, including selection and monitoring of investment alternatives.[115] The DOL has issued guidance in how fiduciaries may comply with their fiduciary obligations in dealing with the investment of plan assets and selecting appropriate investment alternatives for participant-directed account plans.[116] As noted earlier, the fiduciary standards extend beyond the selection of plan investments to a duty to monitor investments to insure that they continue to be prudent investments or investment alternatives for the plan.[117]

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111. *See id.* § 1104(a)(1)(D). The documents and instruments of the plan need only be followed to the extent they are consistent with the other provisions of ERISA. *Id.*

112. ERISA § 409(a), 29 U.S.C. § 1109(a) (1994). This section imposes personal liability on plan fiduciaries to restore losses to a plan resulting from a breach of fiduciary duty. *See also* Conner v. Mid S. Ins. Agency, 943 F. Supp. 647, 659-60 (W.D. La. 1995) (holding that plan fiduciaries are not insulated from liability for their breaches under the liability exemption provided by ERISA section 404(c) simply because the plan participants were permitted to and in fact did exercise control over the assets in their accounts).

113. *See* O'Neil v. Retirement Plan for Salaried Employees of RKO Gen., Inc., 37 F.3d 55, 61 (2d Cir. 1994) (holding under ERISA section 404(a)(1)(D) that "a fiduciary must discharge its duties with respect to a plan in accordance with the documents and instruments governing the plan").

114. *See id.*; *see also* ERISA § 401(a), 29 U.S.C. § 1104(a)(1)(D) (1994). Therefore, the plan documents must be followed to the extent the documents are consistent with ERISA, but the fiduciary must discharge its discretionary functions solely in the interest of the plan participants and beneficiaries. *See O'Neil*, 37 F.3d at 61.

115. *See* Rules and Regulations for Fiduciary Responsibility, 29 C.F.R. § 2550.404a-1 (1998).

116. *Id. See also In re* Unisys Sav. Plan Litig., 74 F.3d 420, 434 (3d Cir. 1996) (applying the ERISA section 404(a) fiduciary standards, to which the regulations at 29 C.F.R. § 2550.404a-1 apply, to a participant-directed (ERISA section 404(c)) plan).

117. *See* Collins, *supra* note 1; *see also Unisys*, 74 F.3d at 443 (holding that Unisys owed a duty to disclose information to plan participants about the deteriorating financial condition of an

In *Unisys*, the court presented a method to determine whether the fiduciary has satisfied his or her duties in connection with selection of plan investment alternatives. The court recognized a duty by plan fiduciaries to "conduct an independent investigation into the merits of a particular investment [alternative]."[118] In discharging this duty, the court encouraged the use of consultants and professional advisors, but warned that the advice received from a consultant or advisor should not be relied upon blindly.[119] While the court did not recommend duplicating the efforts of professional advice, it required the fiduciary to assess the information provided by the consultant or advisor, to supplement the information where necessary, and to make the ultimate decision as to the prudence of a particular investment.[120]

The court also endorsed the standard expressed by Judge Scalia (now Justice Scalia) in *Fink v. National Savings and Trust Co.*,[121] that the determination of a given decision's prudence should be evaluated on "the basis of what the [fiduciary] knew or should have known."[122] This "should have known" standard is consistent with the current DOL regulations which provide that a fiduciary's duties are only satisfied after giving "appropriate consideration to those facts and circumstances that . . . the fiduciary knows or should know are relevant to the particular investment . . . ."[123] In light of this standard, it is unlikely that a fiduciary will discharge its duty properly with respect to selecting investment alternatives when a plan allows a very large number of investment alternatives. The ultimate responsibility is on the plan sponsor or other fiduciary to decide which funds represent prudent investments without blind reliance upon the representations or opinions of the fund provider.

In connection with the investment alternatives, the fiduciary has a duty to give complete and accurate information without materially misrepresenting the facts.[124] In addition to the standard that "when a [fiduciary] speaks, it must speak truthfully,"[125] the court in *Unisys* recognized "not only a negative duty not to misinform, but also an affirmative duty to inform when the [fiduciary] knows that silence might be harmful."[126] The court applied this standard in *Unisys* when an

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insurance company providing a guaranteed investment contract alternative to the plan).

118. *Unisys*, 74 F.3d at 435.

119. *Id.* at 435-36.

120. *Id.*

121. 772 F.2d 951 (D.C. 1985).

122. *Unisys*, 74 F.3d at 436 (citing Fink v. National Sav. & Trust Co., 772 F.2d 951, 962 (D.C. Cir. 1985) (Scalia, J., concurring in part and dissenting in part)).

123. Rules and Regulations for Fiduciary Responsibility, 29 C.F.R. § 2550.404a-1(b)(1)(i) (1998).

124. *See, e.g.*, *Unisys*, 74 F.3d at 441; Drennan v. General Motors Corp., 977 F.2d 246, 251 (6th Cir. 1992).

125. *Unisys*, 74 F.3d at 442 (quoting Fischer v. Philadelphia Elec. Co., 994 F.2d 130, 135 (3d Cir. 1993)).

126. *Id.* at 441 (quoting Bixler v. Central Pa. Teamsters Health & Welfare Fund, 12 F.3d 1292, 1300 (3d Cir. 1993)).

insurance company providing an investment alternative under the plan encountered severe financial distress.[127] While unable to rule on whether the fiduciaries involved breached their duty, because material questions of fact remained, the court indicated that the fiduciaries had a duty to inform the participants of the financial condition of the insurance company.[128]

Plan fiduciaries have many duties to fulfill with respect to a plan and its participants. However, they do not bear unlimited liability for losses incurred by the plan. Under the statutory language of ERISA section 409(a), plan fiduciaries are liable only for losses resulting from their breaches.[129] Additionally, the actions that may constitute a breach, which exposes a fiduciary to liability, are limited to those actions or events occurring while the person or entity is a plan fiduciary.[130] Relevant case law supports the requirement of a causal relationship between the act constituting the breach and the loss to the plan.[131]

In *Reich v. McManus*,[132] the defendant brokers were alleged to have acquired fiduciary status by their exercise of discretionary control over the investment of certain plan assets and by giving investment advice. The court held that a person acquiring fiduciary status by either of these actions is liable for losses only to the extent that they performed these respective functions.[133] Therefore, all plan fiduciaries are not exposed to liability simply because there is a loss to the plan; a plaintiff must show a relationship between the fiduciary's action and the claimed loss.

A similar issue was presented by *Payonk v. HMW Industries, Inc.*[134] The defendant involved in *Payonk*, however, was the employer, who also served as a plan fiduciary. In *Payonk*, the employer/fiduciary decided to terminate the plan which adversely affected certain participants who had "opted out" of the plan shortly before the termination.[135] The employer did not inform the participants or beneficiaries of the decision to terminate the plan until notices required by statute had to be given.[136] The plaintiffs claimed that the employer, as a plan fiduciary, breached its duty to inform by withholding information about the plan termination. The court, however, agreed with the defendant employer's contention that the decision to terminate the plan was a business decision and was not subject to ERISA's fiduciary requirements.[137] "[W]hen an employer

127. *Id.*

128. *Id.* at 443.

129. 29 U.S.C. § 1109(a) (1994).

130. *Id.* § 1109(b). Plan fiduciaries are not liable as fiduciaries for actions which occur before one became a fiduciary or after one ceases to be a fiduciary. *Id.*

131. *See, e.g.*, Payonk v. HMW Indus., Inc., 883 F.2d 221, 225 (3d Cir. 1989); Reich v. McManus, 883 F. Supp. 1144, 1148 (N.D. Ill. 1995).

132. 883 F. Supp. 1144 (N.D. Ill. 1995).

133. *Id.* at 1148.

134. 883 F.2d 221, 224-25 (3d Cir. 1989).

135. *Id.* at 223-24.

136. *Id.* at 224.

137. *Id.* at 229.

wears 'two hats' as employers and as [fiduciaries] . . . they assume fiduciary status 'only when and to the extent' that they function in their capacity as [fiduciaries], not when they conduct business that is not regulated by ERISA."[138] This case extends the notion that fiduciaries are liable only for losses that result from their actions to exclude situations in which a plan fiduciary is not acting within his or her fiduciary capacity.

III. DANGERS OTHER THAN POTENTIAL FIDUCIARY LIABILITY: FREQUENT ACCOUNT ACCESS BY PARTICIPANTS AND BENEFICIARIES

Many plans that allow participants and beneficiaries to control the investment of the assets in their accounts permit automated transactions via telephone or computer.[139] These systems allow participants and beneficiaries to reallocate existing assets and to change elections for the investment of future contributions.[140] This control suggests that a given participant or beneficiary may have a significant impact on the investment performance he or she will experience while participating in the plan. Since the majority of plan participants and beneficiaries lack formal training in making investment decisions, poor investment performance is a likely result.[141] Furthermore, the ease with which a participant or beneficiary may access his or her account to make changes may lead to an increase in account activity. Since poor investment performance is the expected result of decisions made by untrained investors, an increase in changes to investment choices will most likely compound the problem and further depress account performance.[142] Poor investment performance over one's entire period of plan participation may have a significant effect on the level of assets available at retirement.[143]

The current regulations do not protect participants and beneficiaries from poor investment performance in participant-directed account plans. The regulations explicitly state that plan fiduciaries have no obligation to give

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138. *Id.* at 225 (quoting Amato v. Western Union Int'l, Inc., 773 F.2d 1402, 1416-17 (2d Cir. 1985)).

139. I.R.S. Notice 99-1, 1999-2 I.R.B. 8.

140. The regulations do permit reasonable restrictions on how often investment instructions may be given with respect to a specific investment alternative. Rules and Regulations for Fiduciary Responsibility, 29 C.F.R. § 2550.404c-1(b)(2)(ii)(C) (1998). However, the ease by which automated transactions may be processed will likely lead plan sponsors to provide more liberal access.

141. *See* Hoecker & Campbell, *supra* note 36, at 213.

142. *See id.*

143. For example, assume a participant has monthly account additions of 6% of salary, earns a level salary of $40,000 per year, and works for 30 years. The participant will accumulate about $456,000 by retirement if the account earns an average of 10% per year. However, if under the same set of assumptions the account achieves only 5% earnings per year, the participant will accumulate only about $167,000.

investment advice.[144] In fact, as discussed earlier, rendering investment advice is discouraged by ERISA because it could lead to additional fiduciary liability.[145] The DOL issued Interpretive Bulletin 96-1, distinguishing investment advice from investment education, to give guidance on the types of investment-related information plan fiduciaries *may* provide participants and beneficiaries without losing their ERISA section 404(c) liability protection.[146] However, the regulations contained in the bulletin still do not *require* plan fiduciaries to provide any type of investment education to participants and beneficiaries who must make the investment decisions.[147]

The only information that must be given to plan participants and beneficiaries to assist them in making their investment decisions is that specified by the required disclosure provisions in the regulations.[148] While items required by the disclosure provisions, such as risk and return characteristics, historical performance, and prospectuses, are important to making investment decisions, they may be inadequate for someone who has not been given some information about general investment principles or the differences between asset classifications.

If plan participants and beneficiaries make their own investment decisions with respect to their retirement savings and poor asset performance is the result, many different problems could arise. Poor investment performance could force some participants to postpone their retirement to accumulate additional funds.[149] Not all individuals will have the option of postponing their retirement. Health problems may force retirees with insufficient retirement benefits to rely on their families or the state for financial assistance.

IV. Possible Remedies

The problems of compliance and possible fiduciary exposure by plan fiduciaries and the increased burden on plan participants to assume investment risks could be remedied by a couple of different methods. The first potential remedy calls for the DOL and the courts to require strict compliance with the provisions in the existing regulations. A second possibility is to revise or interpret the existing regulations in such a way as to make compliance by plan sponsors and other plan fiduciaries easier to achieve, relieving some of the risk

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144. Rules and Regulations for Fiduciary Responsibility, 29 C.F.R. § 2550.404c-1(c)(4) (1998).

145. *See supra* notes 94-107 and accompanying text.

146. *Interpretive Bulletins*, 29 C.F.R. § 2509.96-1 (1998). *See supra* notes 98-107 and accompanying text.

147. 29 C.F.R. § 2509.96-1 (1998).

148. *See id.* § 2550.404c-1(b)(2)(i)(B).

149. Increased life expectancies and inflation require a larger accumulation for retirement than in the past. If participants and beneficiaries are to bear the investment risk of their retirement assets and wish to retire before reaching their seventies, good investment performance is necessary.

of fiduciary liability for noncompliance. Changes to the current statutory language or regulations should be made with the goals of ERISA in mind: To protect the interests of plan participants and beneficiaries in private pension plans and to promote a healthy private pension system.[150]

A. Strict Compliance Requirement

The existing statutory language and regulations could be interpreted strictly by the DOL and the courts to promote ERISA's primary purpose. One fiduciary role likely to be impacted by this approach would be the selecting and monitoring of investment alternatives from which participants and beneficiaries may choose. A strict application of the regulations would force plan fiduciaries to offer only prudent, well-diversified investment alternatives and would require fiduciaries to monitor all investment alternatives to ensure that they remain prudent.[151] Holding fiduciaries to a high standard and imposing fiduciary liability to ensure compliance will allow plan participants to choose from sound investment choices and help minimize the risk of losses and poor investment performance due to their investment decisions.

If plan fiduciaries knew they would be held to strict compliance standards or face significant liability, the current disclosure procedures would likely change. In order to meet the disclosure requirements pertaining to investment alternative descriptions, fees, limitations on instructions, and restrictions on transfer which apply to all investment alternatives,[152] plan fiduciaries may be more inclined to limit the number of investment alternatives, thus limiting the required disclosure to a level which may be managed and monitored.[153] Fewer funds would make participant investment choices easier and the disclosure requirements more practical. If the number of funds is limited, a participant or beneficiary may be more likely to utilize the disclosure materials provided to make an informed choice.[154] A participant is not likely to review disclosure materials for tens or hundreds of different investment alternatives. This makes such disclosure moot and renders the requirement ineffective in promoting one of ERISA's main

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150. *See, e.g.*, ERISA §§ 2(b) & (c), 29 U.S.C. §§ 1001(b) & (c) (1994) (stating the policy of ERISA as "to protect . . . the interests of participants in employee benefit plans and their beneficiaries" and to "improv[e] the equitable character and soundness of such plans"). *See also* H.R. REP. NO. 93-533 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4639, 4639-43 (stating the primary purpose of ERISA is the "protection of individual pension rights").

151. 29 C.F.R. §§ 2550.404a-1(b), 2550.404c-1(b)(3) (1998).

152. *Id.* §§ 2550.404c-1(b)(2)(i)(B)(1)(ii), (iv) & (v).

153. *See id.* § 2550.404c-1(b)(2)(i)(B)(1)(viii). Limiting the number of funds offered would also make the requirement that a prospectus be provided after each initial investment in an alternative fund easier to monitor. *See id.*

154. A participant may be able to better understand what is available by reviewing the disclosure materials for all of the alternatives. While this will not necessarily increase understanding of investment skills, investment risks may be minimized by offering prudent alternatives.

purposes, to protect the interests of plan participants and beneficiaries.[155]

Along with holding plan fiduciaries to strict compliance with the existing regulations, the regulations should be amended to encourage plan sponsors and other fiduciaries to provide ample investment education and assistance to plan participants and beneficiaries. The DOL Interpretive Bulletin 96-1 has taken a step in this direction by clarifying the types of information that a fiduciary could give to a participant without losing the liability protection of ERISA section 404(c).[156] The DOL could further encourage such education of participants and beneficiaries by offering additional safe harbors to preserve section 404(c) protection or by providing model educational materials that discuss investment theories or charts, graphs, worksheets, or even interactive computer programs similar to those allowed in the interpretive bulletin.[157]

Of course the ultimate encouragement could be provided in the form of mandated investment education of participants and beneficiaries by plan fiduciaries (most likely the plan sponsor). Such a mandate would ensure that all participants and beneficiaries receive a certain minimum amount of information about investment strategies and the different types of funds offered. This mandated program could be active, by requiring distribution of materials or providing a presentation, or passive, by requiring the fiduciary to designate an investment advisor who would be available to provide materials or answer questions.

Under this potential remedy of requiring strict compliance of existing regulations and implementing some changes to promote investment education,[158] the primary goals of ERISA are reasonably served.[159] The effect of strict compliance and education would be to lower the investment risk assumed by participants and beneficiaries, which would protect their interests as well as lead to a healthier private pension system.

B. Relaxed Disclosure Remedy

A second approach to improving the participant-directed account plan arena is to relax the current disclosure requirements to promote flexibility to participants and accommodate the use of current technology.[160] Under this

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155. *See supra* note 150 and accompanying text.

156. *Interpretive Bulletins*, 29 C.F.R. § 2509.96-1(d) (1998).

157. *See id.* § 2509.96-1(d)(2), (3) & (4).

158. Requiring a mandatory educational program could result in discouraging plan sponsors from implementing or maintaining retirement plans due to the increased burden and cost of providing the education. This could work contrary to ERISA's purpose of promoting a healthy private pension system. *See supra* note 150 and accompanying text. The best overall alternative would be for the DOL to implement programs to encourage plan sponsors to provide education voluntarily.

159. *See supra* note 150 and accompanying text.

160. It may be more feasible to provide some disclosure items such as investment descriptions or transaction confirmation electronically, however, many disclosure items are required to be given

scenario, a plan could safely offer as many investment alternatives as it found to be feasible.[161]

To implement this remedy, the current disclosure requirements could be modified so that plan fiduciaries would remain in compliance and their section 404(c) fiduciary protection from losses due to the investment decisions made by plan participants and beneficiaries would be preserved. One way the disclosure requirements could be modified is to limit automatic disclosure to "core" investment alternatives. For example, the plan fiduciary would provide only a description of the core investments along with their risk and return characteristics rather than provide this information for all investment alternatives.[162] If participants wanted the information on other available alternatives, the plan fiduciary would have a duty to provide it only upon request of the participant. The regulations could permit plans to make this type of information available through a participant-accessible database. In order to provide adequate investment alternatives to those who do not inquire about the other available alternatives, the core investment alternatives would have to meet all of the diversity and prudence requirements currently in the regulations.

The prospectus requirement could also be relaxed to require that prospectuses be provided only upon request of the participant.[163] With respect to the core investment alternatives, the prospectus requirement could be left unchanged[164] or revised to provide that prospectuses for all core alternatives be distributed to a participant upon entering the plan or to a beneficiary who becomes eligible to receive benefits from the plan.

Many of the disclosure requirements would not need to be changed to maintain compliance when a large number of investment alternatives are offered. For example, the fiduciary still would have to provide a statement that the plan is intended to qualify as a section 404(c) plan and the investment managers and plan fiduciaries still would have to be identified automatically to all participants and beneficiaries.[165]

Congress may have already taken a step toward relaxing some of the existing requirements governing section 404(c) plans. The Taxpayer Relief Act of 1997 calls for regulations interpreting several existing requirements under ERISA and the Internal Revenue Code, including disclosure, notice, and election

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in writing. It is not clear if providing such information electronically satisfies such a requirement. *See, e.g.*, Rules and Regulations for Fiduciary Responsibility, 29 C.F.R. § 2550.404c-1(b)(2)(i)(A) (1998).

161. With automated transactions and data transfer this could be an almost unlimited number. *See* Hoecker & Campbell, *supra* note 36, at 213.

162. *See* 29 C.F.R. § 2550.404c-1(b)(2)(i)(B)(1)(ii) (1998).

163. *See id.* § 2550.404c-1(b)(2)(i)(B)(1)(viii). This section currently requires a prospectus be provided whenever a participant or beneficiary makes an initial investment into an alternative. *Id.*

164. *See id.*

165. *See id.* §§ 2550.404c-1(b)(2)(i)(B)(1)(i), (iii) & (vi).

requirements, as they apply to the use of new technologies.[166] The Act also calls for regulations clarifying when the writing requirements of the Internal Revenue Code will be satisfied by paperless transactions.[167] However, the Act fails to mention expanding the writing requirements of ERISA to include paperless transactions. It is not clear why paperless transactions would not be allowed under ERISA as well as the Internal Revenue Code. The answer may lie with the final regulations that are called for in the Act.[168]

An area of concern under this relaxed disclosure remedy is, again, the investment education of participants and beneficiaries. Increasing alternatives and relaxing disclosure makes the participants' decisions more difficult and their investment risk greater. A system of education should be included in the statutory or regulatory changes implementing this type of scenario if ERISA's purposes are to be served. A fiduciary obligation to provide investment education would help reduce the increased burden to the participants and beneficiaries of fund selection and investment risk.

Conclusion

Due to advances in technology and in the attempt to meet the expectations of plan participants and beneficiaries, participant-directed plans offer an increasing number of investment alternatives and account access. This increased flexibility may be viewed as a benefit by participants, beneficiaries, and plan sponsors, but it could lead to problems for both sides.

Plan sponsors and other plan fiduciaries are less likely to meet the requirements of ERISA section 404(c) and the accompanying DOL regulations when offering a large number of investment choices. Noncompliance could result in significant fiduciary liability exposure by removing the protection offered by section 404(c).

Plan participants and beneficiaries will experience more investment risk and will face the likelihood of poor investment performance. This could result in account balances that are inadequate to allow participants to retire at the time or at the standard of living that they had expected.

Strictly enforcing the existing regulations would encourage compliance and protect the investments of participants and beneficiaries, as well as promote the purposes of ERISA. However, this is not a practical solution because it discourages the use of technology to streamline the administration of these types of plans.

A better solution would be to revise the existing regulations to allow plan sponsors to offer the types of plans being demanded by the marketplace while remaining in compliance and minimizing their fiduciary liability exposure. A necessary addition to the regulations under this scenario is to require some level

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166. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 1510(a), 111 Stat. 788, 1068-69 (1997).

167. *Id.* at 1069.

168. *See supra* note 7.

of investment education for plan participants and beneficiaries sufficient to allow them to make intelligent choices while facing a myriad of investment options. The educational provision is necessary to protect the interests of participants and beneficiaries within the stated purposes of ERISA.