

ERISA Section 404(c) Protection: A Refresher for Fiduciaries

by Kenneth F. Ginder on October 19, 2022

The Employee Retirement Income Security Act (“ERISA”) imposes both (i) significant responsibilities on fiduciaries of participant-directed individual account plans, including 401(k) plans, and (ii) personal liability for losses suffered by a plan if those responsibilities are breached. Fortunately, ERISA provides important relief from liability for investment losses for these types of retirement plans if certain requirements are met. This relief is sometimes referred to as “ERISA Section 404(c) Protection” or simply “404(c) Protection,” and many fiduciaries assume they have 404(c) Protection. The purpose of this post is to remind fiduciaries that 404(c) Protection is available only if certain requirements are continually met. It also provides a high-level summary of the key requirements and recommends that fiduciaries periodically review their plan operations to ensure compliance. No fiduciary wants to discover that 404(c) Protection is unavailable after an investment loss has occurred.

Section 404(c) of ERISA relieves fiduciaries from liability for participants’ and beneficiaries’ investment decisions in participant-directed individual account plans if the following four requirements are met:

1. **Opportunity to Control Assets.** Participants and beneficiaries must be provided the opportunity to exercise control over assets in their individual accounts. This requirement is met only if:
 - a. the participant or beneficiary has a reasonable opportunity to give investment instructions to a plan fiduciary who is obligated to comply with the instructions (subject to certain reasonable restrictions); and
 - b. the participant or beneficiary has the opportunity to obtain sufficient information to make informed investment decisions with respect to investment alternatives available under the plan. (The information requirement is discussed further in item 4 below.)
2. **Exercise of Independent Control.** Section 404(c) Protection is available only for investment transactions where the participant or beneficiary has in fact exercised independent control.¹ Whether a participant or beneficiary has exercised independent control will be judged based on the facts and circumstances of the situation; however, the regulations make clear there will

¹ Although beyond the scope of this post, we note that if participants or beneficiaries fail to provide investment instructions, fiduciaries can obtain similar relief from liability if they invest the assets in accordance with the qualified default investment alternative (“QDIA”) rules.

- be no finding of independent exercise of control if the participant or beneficiary is subject to improper influence by the fiduciary or plan sponsor, the fiduciary has concealed material non-public facts, or the participant or beneficiary is legally incompetent.
3. **Broad Range of Investment Alternatives.** The plan must offer a broad range of investment alternatives. This requirement is satisfied if the investment alternatives provide participants and beneficiaries with a reasonable opportunity to:
 - a. materially affect the potential return on amounts in their accounts and the degree of risk to which those amounts are subject;
 - b. choose from at least three diversified investment alternatives, each of which has materially different risk and return characteristics; and
 - c. diversify investments to minimize the risk of large losses.
 4. **Disclosure of Information.** Participants and beneficiaries will be deemed to have sufficient information to make informed investment decisions if they are provided with the following:
 - a. An explanation that the plan is intended to comply with Section 404(c) and the fiduciaries may be relieved of liability for any losses which are the result of investment instructions given by the participant or beneficiary.
 - b. Three types of plan-related information: (1) general plan information; (2) information about administrative expenses; and (3) information about individual expenses. General plan information includes an explanation of the circumstances under which participants and beneficiaries may give investment instructions, and a description of the investment alternatives offered under the plan. In addition, administrative and individual expenses that may be charged against a participant's or beneficiary's account must be disclosed.
 - c. Four types of investment-related information for each investment alternative offered under the plan: (1) identifying information; (2) performance data; (3) benchmarks; and (4) fees and expenses.
 - d. With respect to an employer stock fund, a description of the procedures established for ensuring the confidentiality of information relating to the purchase, holding, and sale of employer stock, and the exercise of voting tender and similar rights, by participants and beneficiaries; and the name, address and phone number of the plan fiduciary responsible for monitoring compliance with these procedures.
 - e. In addition to the information described in a through d above, the following information must be provided upon request: copies of prospectuses; copies of financial statements and similar materials, to the extent the information is provided to the plan; a statement of the value of a share (or unit) of each designated investment alternative as well as the date of the valuation; and

a list of the assets comprising the portfolio of each designated investment alternative which constitutes plan assets and the value of such assets.²

We recommend that fiduciaries periodically review their plan operations to ensure that they are in compliance with all aspects of Section 404(c) and document their review. We note that the disclosure requirement likely raises the greatest risk of non-compliance because it involves an ongoing requirement to provide significant amounts of information to participants and beneficiaries, and many fiduciaries rely on third parties to comply with some or all the required disclosures. We caution against simply assuming the required information is being disclosed. Fiduciaries should confirm it is being disclosed and monitor applicable service providers. In addition, fiduciaries should review service agreements to ensure they outline the service provider's obligations with respect to disclosures.

Two final notes to bear in mind. First, it is important to understand that Section 404(c) Protection does not relieve fiduciaries from liability with respect to selecting and monitoring investment alternatives. Fiduciaries have a continuing duty to monitor the investments they are making available to participants and beneficiaries. Second, complying with Section 404(c) is optional, and non-compliance does not automatically trigger liability for investment losses.³ Instead, non-compliance eliminates the broad relief available and raises the possibility that a fiduciary could be held liable for investment losses in participants' and beneficiaries' accounts.

If you have any questions about ERISA 404(c) Protection, please contact a member of Verrill's Employee Benefits and Executive Compensation Group.



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² The information in items a through d is intended to enable participants and beneficiaries to make "informed investment decisions," and the regulations state that it "must be provided on or before the date on which a participant or beneficiary can first direct his or her investments," and certain information must be provided at least annually thereafter.

³ Note, however, that the disclosures described in 4b and 4c above are separately required by regulations under Section 404(a) of ERISA.