Client Advisory

KELLEY DRYE

EMPLOYEE BENEFITS AND EXECUTIVE COMPENSATION JUNE 2009

Key Issues 401(k) Plan Fiduciaries Need to Know

Substantial losses incurred by 401(k) accounts, a rise in class action lawsuits against fiduciaries for losses incurred by plans, and the Department of Labor's attention to fees and expenses paid out of plan assets has intensified the pressure on plan fiduciaries to be extra cautious about their obligations under ERISA.

Here is an outline of some of the issues that plan fiduciaries must consider in selecting and monitoring investment options and the costs associated with the management of plan investments.

ERISA SECTION 404(c)

ERISA Section 404(c) provides limited relief from fiduciary liability for losses resulting from participant-directed 401(k) plans if certain requirements are satisfied. Participants must be provided with notice that the plan is designed to comply with Section 404(c). The plan must offer a broad range of investment alternatives with materially different risk and return characteristics and permit transfers among the funds at least quarterly. Participants must be provided with enough information to permit informed decision making. Plan fiduciaries are responsible for the prudent selection and monitoring of investment options.

SELECTION OF INVESTMENT OPTIONS

Fiduciaries must determine the proper allocation of asset classes and styles for the plan and prudently select investment options to fill each class and style. Investment options should not be highly correlated, they should cover the spectrum of risk and reward, and they should not be over-weighted in a particular asset class due to multiple fund offerings.

INVESTMENT POLICY STATEMENT

This is a critical document because in determining whether a plan fiduciary has fulfilled his or her fiduciary duty under ERISA, courts will generally look to the "process" rather than the "outcome." An investment policy statement can provide a procedural roadmap for Section 404(c) compliance. It should outline the essential criteria that the plan's fiduciaries should consider in selecting, retaining and terminating investment managers and in selecting investment options. Criteria relevant in selecting investment managers and options include the manager's style and discipline, firm experience, personnel turnover, financial resources, staff, fees, reputation, correlation of the option to the asset class being implemented and past performance relative to other investments having similar investment objectives.

MONITORING AND EVALUATING INVESTMENT OPTIONS

Plan fiduciaries are not immune from liability after choosing an investment manager and investment options; both must be monitored continuously. Fiduciaries should analyze performance reports that measure an investment option's performance against appropriate benchmarks. If a fiduciary determines that the investment option is consistently underperforming, it may be prudent to replace the option.

FEES AND REVENUE SHARING

ERISA requires that fees and expenses charged to a plan be "reasonable." Reasonableness can be determined by benchmarking the level and quality of the services provided against other plans with similar characteristics and features. Plan fiduciaries should document any analysis and conclusions regarding fees and consider any revenue sharing arrangements and take these payments into account in negotiating and evaluating service provider fees.

THE "PLAN FIDUCIARIES' ERISA COMPLIANCE INVESTMENT ASSESSMENT"

This advisory outlines only a few of the numerous, complex issues that fiduciaries must address. If you are interested in an ERISA Compliance Investment Assessment, which would address your particular circumstances, or if you have questions about any fiduciary issues under ERISA, please contact any member of Kelley Drye's Employee Benefits and Executive Compensation Practice Group listed below.

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