

U.S. Department of Labor

Pension and Welfare Benefits Administration
Washington, D.C. 20210



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96-02A

Donald S. Carnow, J.D., A.P.M.
Carnow and Associates, Ltd.
778 Frontage Road, Suite 101
Northfield, IL 60093

Dear Mr. Carnow:

This is in response to your letter of February 16, 1995, requesting guidance concerning whether, in a participant-directed eligible individual account plan designed to satisfy the requirements of section 404(c) of the Employee Retirement Income Security Act ("ERISA"), the failure of trustees to follow the last affirmative investment directions of participants who can no longer be located would cause the plan to lose its status as a "section 404(c) plan."

You state that Stack-On Products Company (the Company) has, over the years, employed a number of documented immigrants. In 1994, the Company was found by the Immigration and Naturalization Service (INS) to have among its employees certain individuals who had non-qualifying alien registration numbers, and certain others who had unlawfully assumed the identities of properly documented workers. Your letter indicates that all of these individuals, who were terminated by the Company, were active participants in the Company's 401(k) plan (the Plan), a plan designed to satisfy the requirements of section 404(c) of ERISA. You state further that while some of these individuals have reappeared with INS approval under their proper names and had their account balances properly credited to them, others, despite the Company's diligent efforts to locate them, cannot be found.

According to your letter, the trustees of the Plan have diligently sought to locate the terminated employees, and have set up a procedure to restore the benefits of those who show up using proper identities. The trustees are concerned, however, about protecting the plan assets in the accounts of those participants who cannot be located, because, in some instances, continuing to follow the participant's last investment directive may not be prudent. The trustees therefore propose to transfer the missing participants' account balances to a balanced investment fund actively managed by a professional money manager. In effect, you ask whether the plan will lose its status as a section 404(c) plan if the trustees fail to follow the missing participants' last investment instructions.

Section 404(c) of ERISA provides that, where a participant or beneficiary of an employee benefit plan exercises control over assets in an individual account maintained for him under the plan, the participant or beneficiary is not considered a fiduciary by reason of his exercise of control and other plan fiduciaries are relieved of liability under part 4 of title I of ERISA for the results of the participant's exercise of control.

A regulation under section 404(c) was issued on October 13, 1992, at 29 C.F.R. § 2550.404c-1 (hereafter, "the regulation"). The regulation provides generally that, in order for the protection from liability afforded by section 404(c) to be available, participants and beneficiaries must have the opportunity to: (1) choose from a broad range of investment alternatives, which consist of at least three diversified investment alternatives, each of which has materially different risk and return characteristics; (2) give investment instruction with a frequency which is appropriate in light of the market volatility to which the investment alternatives may reasonably be expected to be subject, but not less frequently than once within any three month period; (3) diversify investments within and among investment alternatives; and (4) obtain sufficient information to make informed investment decisions with respect to

investment alternatives available under the plan. The regulation is generally effective with respect to transactions occurring on or after the first day of the second plan year beginning after October 13, 1992.

The preamble to the regulation explains that as long as transfer opportunities are made available to participants and beneficiaries in accordance with the regulation, including former employee-participants, an affirmative election may be given effect until affirmatively revoked by the participant or beneficiary.¹ As you mention in your letter, however, there may be circumstances in which plan fiduciaries believe that giving indefinite effect to the affirmative election of a participant or beneficiary who cannot be located may not be prudent.

The regulation defines an ERISA section 404(c) plan as an individual account plan that (i) provides an opportunity for a participant or beneficiary to exercise control over the assets in his individual account; and (ii) provides a participant or beneficiary an opportunity to choose, from a broad range of investment alternatives, the manner in which some or all of the assets in his or her account are invested. (See 29 CFR 2550.404c-1(b)(1).) Pursuant to § 2550.404c-1(b)(2)(i), a plan provides a participant or beneficiary an opportunity to exercise control over the assets in his account only if, under the terms of the plan, the participant or beneficiary has a reasonable opportunity to give investment instructions to an identified plan fiduciary who is generally obligated to comply with such instructions. Further, as explained in § 2550.404c-1(c), the relief provided under section 404(c) and the implementing regulation is available only with respect to a transaction where a participant or beneficiary has exercised independent control in fact with respect to the investment of assets in his or her individual account under an ERISA section 404(c) plan. Whether a participant has exercised independent control in fact with respect to a transaction depends on the facts and circumstances of the particular case.

In the Department's view, a plan that provides opportunities for participants or beneficiaries to exercise control over the assets in their individual accounts and to choose from a broad range of investment alternatives the manner in which assets in their account are invested does not lose its status as an ERISA section 404(c) plan merely because the fiduciaries of the plan decide to override the last investment direction of a missing participant or beneficiary, where the fiduciaries have determined that continuing to follow the direction would not be prudent.² It is important to note, however, that any such exercise of control by plan fiduciaries with respect to assets in an individual account would supersede the exercise of control, within the meaning of the regulation, by the missing participant or beneficiary. Therefore, the transactional relief afforded by section 404(c) of ERISA would not be available with respect to investment decisions made by the plan fiduciaries on behalf of such missing participants and beneficiaries.

Finally, it should be noted that the standards set forth in the section 404(c) regulation are applicable solely for the purpose of determining whether a plan is an ERISA section 404(c) plan and whether a particular transaction engaged in by a participant or beneficiary of such plan is afforded relief by section 404(c). They are not intended to be applied in determining whether a non-complying plan or transaction satisfies the fiduciary responsibility or other provisions of Title I of ERISA. Accordingly, although a plan fiduciary who overrides the investment directions of a missing participant would not be accorded the statutory relief described in section 404(c), the fiduciary would not necessarily violate ERISA, provided the fiduciary standards of Title I are met. These include, but are not limited to, requirements that fiduciaries discharge their duties with respect to a plan; solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan;³ with the care, skill, prudence and diligence under the circumstances

¹ 57 Fed. Reg. 46906, at 46918.

² This letter does not address or opine on the steps fiduciaries of a plan should take to locate missing participants. In the Department's view, that question is inherently factual and must be resolved by the appropriate plan fiduciaries in accordance with ERISA's general fiduciary responsibility provisions.

³ ERISA section 404(a)(1)(A)

then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;⁴ by diversifying the investments of the plan so as to minimize the risk of large losses unless it is clearly prudent not to do so;⁵ and in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with Titles I and IV of ERISA.⁶

This letter constitutes an advisory opinion under ERISA Procedure 76-1. Accordingly, it is issued subject to the provisions of that procedure, including section 10 thereof relating to the effect of advisory opinions.

Sincerely,

BETTE J. BRIGGS
Chief, Division of Fiduciary Interpretations
Office of Regulations and Interpretations

⁴ ERISA section 404(a)(1)(B)

⁵ ERISA section 404(a)(1)(C)

⁶ ERISA section 404(a)(1)(D)