

SUBCHAPTER F—FIDUCIARY RESPONSIBILITY UNDER THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

PART 2550—RULES AND REGULATIONS FOR FIDUCIARY RESPONSIBILITY

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AUTHORITY: 29 U.S.C. 1135; and Secretary of Labor’s Order No. 6-2009, 74 FR 21524 (May 7, 2009). Secs. 2550.401b-1, 2550.408b-1, 2550.408b-19, 2550.408g-1, and 2550.408g-2 also issued under sec. 102, Reorganization Plan No. 4 of 1978, 5 U.S.C. App. Sec. 2550.401c-1 also issued under 29 U.S.C. 1101. Sections 2550.404c-1 and 2550.404c-5 also issued under 29 U.S.C. 1104. Sec. 2550.407c-3 also issued under 29 U.S.C. 1107. Sec. 2550.404a-2 also issued under 26 U.S.C. 401 note (sec. 657(c)(2), Pub. L. 107-16, 115 Stat. 38, 136 (2001)). Sec. 2550.408b-1 also issued under 29 U.S.C. 1108(b)(1). Sec. 2550.408b-19 also issued under sec. 611(g)(3), Public Law 109-280, 120 Stat. 780, 975 (2006).

§ 2550.401c-1 Definition of “plan assets”—insurance company general accounts.

(a) *In general.* (1) This section describes, in the case where an insurer issues one or more policies to or for the benefit of an employee benefit plan (and such policies are supported by assets of an insurance company’s general account), which assets held by the insurer (other than plan assets held in its separate accounts) constitute plan assets for purposes of Subtitle A, and Parts 1 and 4 of Subtitle B, of Title I of

the Employee Retirement Income Security Act of 1974 (ERISA or the Act) and section 4975 of the Internal Revenue Code (the Code), and provides guidance with respect to the application of Title I of the Act and section 4975 of the Code to the general account assets of insurers.

(2) Generally, when a plan has acquired a Transition Policy (as defined in paragraph (h)(6) of this section), the plan's assets include the Transition Policy, but do not include any of the underlying assets of the insurer's general account if the insurer satisfies the requirements of paragraphs (c) through (f) of this section or, if the requirements of paragraphs (c) through (f) were not satisfied, the insurer cures the non-compliance through satisfaction of the requirements in paragraph (i)(5) of this section.

(3) For purposes of paragraph (a)(2) of this section, a plan's assets will not include any of the underlying assets of the insurer's general account if the insurer fails to satisfy the requirements of paragraphs (c) through (f) of this section solely because of the takeover of the insurer's operations from management as a result of the granting of a petition filed in delinquency proceedings in the State court where the insurer is domiciled.

(b) *Approval by fiduciary independent of the issuer*—(1) *In general.* An independent plan fiduciary who has the authority to manage and control the assets of the plan must expressly authorize the acquisition or purchase of the Transition Policy. For purposes of this paragraph, a fiduciary is not independent if the fiduciary is an affiliate of the insurer issuing the policy.

(2) Notwithstanding paragraph (b)(1) of this section, the authorization by an independent plan fiduciary is not required if:

(i) The insurer is the employer maintaining the plan, or a party in interest which is wholly owned by the employer maintaining the plan; and

(ii) The requirements of section 408(b)(5) of the Act are met.¹

¹The Department notes that, because section 401(c)(1)(D) of the Act and the definition of Transition Policy preclude the issuance of any additional Transition Policies after December 31, 1998, the requirement for inde-

(c) *Duty of disclosure*—(1) *In general.* An insurer shall furnish the information described in paragraphs (c)(3) and (c)(4) of this section to a plan fiduciary acting on behalf of a plan to which a Transition Policy has been issued. Paragraph (c)(2) of this section describes the style and format of such disclosure. Paragraph (c)(3) of this section describes the content of the initial disclosure. Paragraph (c)(4) of this section describes the information that must be disclosed by the insurer at least once per year for as long as the Transition Policy remains outstanding.

(2) *Style and format.* The disclosure required by this paragraph should be clear and concise and written in a manner calculated to be understood by a plan fiduciary, without relinquishing any of the substantive detail required by paragraphs (c)(3) and (c)(4) of this section. The information does not have to be organized in any particular order but should be presented in a manner which makes it easy to understand the operation of the Transition Policy.

(3) *Initial disclosure.* The insurer must provide to the plan, either as part of an amended policy, or as a separate written document, the disclosure information set forth in paragraphs (c)(3)(i) through (iv) of this section. The disclosure must include all of the following information which is applicable to the Transition Policy:

(i) A description of the method by which any income and any expense of the insurer's general account are allocated to the policy during the term of the policy and upon its termination, including:

(A) A description of the method used by the insurer to determine the fees, charges, expenses or other amounts that are, or may be, assessed against the policyholder or deducted by the insurer from any accumulation fund under the policy, including the extent and frequency with which such fees, charges, expenses or other amounts may be modified by the insurance company;

pendent fiduciary authorization of the acquisition or purchase of the Transition Policy in paragraph (b) no longer has any application.

(B) A description of the method by which the insurer determines the return to be credited to any accumulation fund under the policy, including a description of the method used to allocate income and expenses to lines of business, business segments, and policies within such lines of business and business segments, and a description of how any withdrawals, transfers, or payments will affect the amount of the return credited;

(C) A description of the rights which the policyholder or plan participants have to withdraw or transfer all or a portion of any accumulation fund under the policy, or to apply the amount of a withdrawal to the purchase of guaranteed benefits or to the payment of benefits, and the terms on which such withdrawals or other applications of funds may be made, including a description of any charges, fees, credits, market value adjustments, or any other charges or adjustments, both positive and negative;

(D) A statement of the method used to calculate any charges, fees, credits or market value adjustments described in paragraph (c)(3)(i)(C) of this section, and, upon the request of a plan fiduciary, the insurer must provide within 30 days of the request:

(1) The formula actually used to calculate the market value adjustment, if any, to be applied to the unallocated amount in the accumulation fund upon distribution of a lump sum payment to the policyholder, and

(2) The actual calculation, as of a specified date that is no earlier than the last contract anniversary preceding the date of the request, of the applicable market value adjustment, including a description of the specific variables used in the calculation, the value of each of the variables, and a general description of how the value of each of those variables was determined.

(3) If the formula is based on interest rate guarantees applicable to new contracts of the same class or classes, and the duration of the assets underlying the accumulation fund, the contract must describe the process by which those components are ascertained or obtained. If the formula is based on an interest rate implicit in an index of publicly traded obligations, the iden-

tity of the index, the manner in which it is used, and identification of the source or publication where any data used in the formula can be found, must be disclosed;

(ii) A statement describing the expense, income and benefit guarantees under the policy, including a description of the length of such guarantees, and of the insurer's right, if any, to modify or eliminate such guarantees;

(iii) A description of the rights of the parties to make or discontinue contributions under the policy, and of any restrictions (such as timing, minimum or maximum amounts, and penalties and grace periods for late payments) on the making of contributions under the policy, and the consequences of the discontinuance of contributions under the policy; and

(iv) A statement of how any policyholder or participant-initiated withdrawals are to be made: first-in, first-out (FIFO) basis, last-in, first-out (LIFO) basis, pro rata or another basis.

(4) *Annual disclosure.* At least annually and not later than 90 days following the period to which it relates, an insurer shall provide the following information to each plan to which a Transition Policy has been issued:

(i) The balance of any accumulation fund on the first day and last day of the period covered by the annual report;

(ii) Any deposits made to the accumulation fund during such annual period;

(iii) An itemized statement of all income attributed to the policy or added to the accumulation fund during the period, and a description of the method used by the insurer to determine the precise amount of income;

(iv) The actual rate of return credited to the accumulation fund under the policy during such period, stating whether the rate of return was calculated before or after deduction of expenses charged to the accumulation fund;

(v) Any other additions to the accumulation fund during such period;

(vi) An itemized statement of all fees, charges, expenses or other amounts assessed against the policy or deducted from the accumulation fund

during the reporting year, and a description of the method used by the insurer to determine the precise amount of the fees, charges and other expenses;

(vii) An itemized statement of all benefits paid, including annuity purchases, to participants and beneficiaries from the accumulation fund;

(viii) The dates on which the additions or subtractions were credited to, or deducted from, the accumulation fund during such period;

(ix) A description, if applicable, of all transactions with affiliates which exceed 1 percent of group annuity reserves of the general account for the prior reporting year;

(x) A statement describing any expense, income and benefit guarantees under the policy, including a description of the length of such guarantees, and of the insurer's right, if any, to modify or eliminate such guarantees. However, the information on guarantees does not have to be provided annually if it was previously disclosed in the insurance policy and has not been modified since that time;

(xi) A good faith estimate of the amount that would be payable in a lump sum at the end of such period pursuant to the request of a policyholder for payment or transfer of amounts in the accumulation fund under the policy after the insurer deducts any applicable charges and makes any appropriate market value adjustments, upward or downward, under the terms of the policy. However, upon the request of a plan fiduciary, the insurer must provide within 30 days of the request the information contained in paragraph (c)(3)(i)(D) as of a specified date that is no earlier than the last contract anniversary preceding the date of the request; and

(xii) An explanation that the insurer will make available promptly upon request of a plan, copies of the following publicly available financial data or other publicly available reports relating to the financial condition of the insurer:

(A) National Association of Insurance Commissioners Statutory Annual Statement, with Exhibits, General Interrogatories, and Schedule D, Part 1A, Sections 1 and 2 and Schedule S—Part 3E;

(B) Rating agency reports on the financial strength and claims-paying ability of the insurer;

(C) Risk adjusted capital ratio, with a brief description of its derivation and significance, referring to the risk characteristics of both the assets and the liabilities of the insurer;

(D) Actuarial opinion of the insurer's Appointed Actuary certifying the adequacy of the insurer's reserves as required by New York State Insurance Department Regulation 126 and comparable regulations of other States; and

(E) The insurer's most recent SEC Form 10K and Form 10Q (stock companies only).

(d) *Alternative separate account arrangements*—(1) *In general*. An insurer must provide the plan fiduciary with the following additional information at the same time as the initial disclosure required under paragraph (c)(3) of this section:

(i) A statement explaining the extent to which alternative contract arrangements supported by assets of separate accounts of insurers are available to plans;

(ii) A statement as to whether there is a right under the policy to transfer funds to a separate account and the terms governing any such right; and

(iii) A statement explaining the extent to which general account contracts and separate account contracts of the insurer may pose differing risks to the plan.

(2) An insurer will be deemed to comply with the requirements of paragraph (d)(1)(iii) of this section if the disclosure provided to the plan includes the following statement:

a. Contractual arrangements supported by assets of separate accounts may pose differing risks to plans from contractual arrangements supported by assets of general accounts. Under a general account contract, the plan's contributions or premiums are placed in the insurer's general account and commingled with the insurer's corporate funds and assets (excluding separate accounts and special deposit funds). The insurance company combines in its general account premiums received from all of its lines of business. These premiums are pooled and

invested by the insurer. General account assets in the aggregate support the insurer's obligations under all of its insurance contracts, including (but not limited to) its individual and group life, health, disability, and annuity contracts. Experience rated general account policies may share in the experience of the general account through interest credits, dividends, or rate adjustments, but assets in the general account are not segregated for the exclusive benefit of any particular policy or obligation. General account assets are also available to the insurer for the conduct of its routine business activities, such as the payment of salaries, rent, other ordinary business expenses and dividends.

b. An insurance company separate account is a segregated fund which is not commingled with the insurer's general assets. Depending on the particular terms of the separate account contract, income, expenses, gains and losses associated with the assets allocated to a separate account may be credited to or charged against the separate account without regard to other income, expenses, gains, or losses of the insurance company, and the investment results passed through directly to the policyholders. While most, if not all, general account investments are maintained at book value, separate account investments are normally maintained at market value, which can fluctuate according to market conditions. In large measure, the risks associated with a separate account contract depend on the particular assets in the separate account.

c. The plan's legal rights vary under general and separate account contracts. In general, an insurer is subject to ERISA's fiduciary responsibility provisions with respect to the assets of a separate account (other than a separate account registered under the Investment Company Act of 1940) to the extent that the investment performance of such assets is passed directly through to the plan policyholders. ERISA requires insurers, in administering separate account assets, to act solely in the interest of the plan's participants and beneficiaries; prohibits self-dealing and conflicts of interest; and requires insurers to adhere to a

prudent standard of care. In contrast, ERISA generally imposes less stringent standards in the administration of general account contracts which were issued on or before December 31, 1998.

d. On the other hand, State insurance regulation is typically more restrictive with respect to general accounts than separate accounts. However, State insurance regulation may not provide the same level of protection to plan policyholders as ERISA regulation. In addition, insurance company general account policies often include various guarantees under which the insurer assumes risks relating to the funding and distribution of benefits. Insurers do not usually provide any guarantees with respect to the investment returns on assets held in separate accounts. Of course, the extent of any guarantees from any general account or separate account contract will depend upon the specific policy terms.

e. Finally, separate accounts and general accounts pose differing risks in the event of the insurer's insolvency. In the event of insolvency, funds in the general account are available to meet the claims of the insurer's general creditors, after payment of amounts due under certain priority claims, including amounts owed to its policyholders. Funds held in a separate account as reserves for its policy obligations, however, may be protected from the claims of creditors other than the policyholders participating in the separate account. Whether separate account funds will be granted this protection will depend upon the terms of the applicable policies and the provisions of any applicable laws in effect at the time of insolvency.

(e) *Termination procedures.* Within 90 days of written notice by a policyholder to an insurer, the insurer must permit the policyholder to exercise the right to terminate or discontinue the policy and to elect to receive without penalty either:

(1) A lump sum payment representing all unallocated amounts in the accumulation fund. For purposes of this paragraph (e)(1), the term penalty does not include a market value adjustment (as defined in paragraph (h)(7) of this section) or the recovery of costs actually incurred which would have been

recovered by the insurer but for the termination or discontinuance of the policy, including any unliquidated acquisition expenses, to the extent not previously recovered by the insurer; or

(2) A book value payment of all unallocated amounts in the accumulation fund under the policy in approximately equal annual installments, over a period of no longer than 10 years, together with interest computed at an annual rate which is no less than the annual rate which was credited to the accumulation fund under the policy as of the date of the contract termination or discontinuance, minus 1 percentage point. Notwithstanding paragraphs (e)(1) and (e)(2) of this section, the insurer may defer, for a period not to exceed 180 days, amounts required to be paid to a policyholder under this paragraph for any period of time during which regular banking activities are suspended by State or federal authorities, a national securities exchange is closed for trading (except for normal holiday closings), or the Securities and Exchange Commission has determined that a state of emergency exists which may make such determination and payment impractical.

(f) *Insurer-initiated amendments.* In the event the insurer makes an insurer-initiated amendment (as defined in paragraph (h)(8) of this section), the insurer must provide written notice to the plan at least 60 days prior to the effective date of the insurer-initiated amendment. The notice must contain a complete description of the amendment and must inform the plan of its right to terminate or discontinue the policy and withdraw all unallocated funds without penalty by sending a written request within such 60 day period to the name and address contained in the notice. The plan must be offered the election to receive either a lump sum or an installment payment as described in paragraph (e)(1) and (e)(2) of this section. An insurer-initiated amendment shall not apply to a contract if the plan fiduciary exercises its right to terminate or discontinue the contract within such 60 day period and to receive a lump sum or installment payment.

(g) *Prudence.* An insurer shall manage those assets of the insurer which are

assets of such insurer's general account (irrespective of whether any such assets are plan assets) with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man 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, taking into account all obligations supported by such enterprise. This prudence standard applies to the conduct of all insurers with respect to policies issued to plans on or before December 31, 1998, and differs from the prudence standard set forth in section 404(a)(1)(B) of the Act. Under the prudence standard provided in this paragraph, prudence must be determined by reference to all of the obligations supported by the general account, not just the obligations owed to plan policyholders. The more stringent standard of prudence set forth in section 404(a)(1)(B) of the Act continues to apply to any obligations which insurers may have as fiduciaries which do not arise from the management of general account assets, as well as to insurers' management of plan assets maintained in separate accounts. The terms of this section do not modify or reduce the fiduciary obligations applicable to insurers in connection with policies issued after December 31, 1998, which are supported by general account assets, including the standard of prudence under section 404(a)(1)(B) of the Act.

(h) *Definitions.* For purposes of this section:

(1) An *affiliate* of an insurer means:

(i) Any person, directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with the insurer,

(ii) Any officer of, director of, 5 percent or more partner in, or highly compensated employee (earning 5 percent or more of the yearly wages of the insurer) of, such insurer or of any person described in paragraph (h)(1)(i) of this section including in the case of an insurer, an insurance agent or broker thereof (whether or not such person is a common law employee) if such agent or broker is an employee described in this paragraph or if the gross income received by such agent or broker from such insurer exceeds 5 percent of such

agent's gross income from all sources for the year, and

(iii) Any corporation, partnership, or unincorporated enterprise of which a person described in paragraph (h)(1)(ii) of this section is an officer, director, or a 5 percent or more partner.

(2) The term *control* means the power to exercise a controlling influence over the management or policies of a person other than an individual.

(3) The term *guaranteed benefit policy* means a policy described in section 401(b)(2)(B) of the Act and any regulations promulgated thereunder.

(4) The term *insurer* means an insurer as described in section 401(b)(2)(A) of the Act.

(5) The term *accumulation fund* means the aggregate net considerations (*i.e.*, gross considerations less all deductions from such considerations) credited to the Transition Policy plus all additional amounts, including interest and dividends, credited to such Transition Policy less partial withdrawals, benefit payments and less all charges and fees imposed against this accumulated amount under the Transition Policy other than surrender charges and market value adjustments.

(6) The term *Transition Policy* means:

(i) A policy or contract of insurance (other than a guaranteed benefit policy) that is issued by an insurer to, or on behalf of, an employee benefit plan on or before December 31, 1998, and which is supported by the assets of the insurer's general account.

(ii) A policy will not fail to be a Transition Policy merely because the policy is amended or modified:

(A) To comply with the requirements of section 401(c) of the Act and this section; or

(B) Pursuant to a merger, acquisition, demutualization, conversion, or reorganization authorized by applicable State law, provided that the premiums, policy guarantees, and the other terms and conditions of the policy remain the same, except that a membership interest in a mutual insurance company may be eliminated from the policy in exchange for separate consideration (e.g., shares of stock or policy credits).

(7) For purposes of this section, the term *market value adjustment* means an

adjustment to the book value of the accumulation fund to accurately reflect the effect on the value of the accumulation fund of its liquidation in the prevailing market for fixed income obligations, taking into account the future cash flows that were anticipated under the policy. An adjustment is a *market value adjustment* within the meaning of this definition only if the insurer has determined the amount of the adjustment pursuant to a method which was previously disclosed to the policyholder in accordance with paragraph (c)(3)(i)(D) of this section, and the method permits both upward and downward adjustments to the book value of the accumulation fund.

(8) The term *insurer-initiated amendment* is defined in paragraphs (h)(8)(i), (ii) and (iii) of this section as:

(i) An amendment to a Transition Policy made by an insurer pursuant to a unilateral right to amend the policy terms that would have a material adverse effect on the policyholder; or

(ii) Any of the following unilateral changes in the insurer's conduct or practices with respect to the policyholder or the accumulation fund under the policy that result in a material reduction of existing or future benefits under the policy, a material reduction in the value of the policy or a material increase in the cost of financing the plan or plan benefits:

(A) A change in the methodology for assessing fees, expenses, or other charges against the accumulation fund or the policyholder;

(B) A change in the methodology used for allocating income between lines of business, or product classes within a line of business;

(C) A change in the methodology used for determining the rate of return to be credited to the accumulation fund under the policy;

(D) A change in the methodology used for determining the amount of any fees, charges, expenses, or market value adjustments applicable to the accumulation fund under the policy in connection with the termination of the contract or withdrawal from the accumulation fund;

(E) A change in the dividend class to which the policy or contract is assigned;

(F) A change in the policyholder's rights in connection with the termination of the policy, withdrawal of funds or the purchase of annuities for plan participants; and

(G) A change in the annuity purchase rates guaranteed under the terms of the contract or policy, unless the new rates are more favorable for the policyholder.

(iii) For purposes of this definition, an insurer-initiated amendment is material if a prudent fiduciary could reasonably conclude that the amendment should be considered in determining how or whether to exercise any rights with respect to the policy, including termination rights.

(iv) For purposes of this definition, the following amendments or changes are not insurer-initiated amendments:

(A) Any amendment or change which is made with the affirmative consent of the policyholder;

(B) Any amendment or change which is made in order to comply with the requirements of section 401(c) of the Act and this section; or

(C) Any amendment or change which is made pursuant to a merger, acquisition, demutualization, conversion, or reorganization authorized by applicable State law, provided that the premiums, policy guarantees, and the other terms and conditions of the policy remain the same, except that a membership interest in a mutual insurance company may be eliminated from the policy in exchange for separate consideration (e.g., shares of stock or policy credits).

(i) *Limitation on liability.* (1) No person shall be subject to liability under Parts 1 and 4 of Title I of the Act or section 4975 of the Internal Revenue Code of 1986 for conduct which occurred prior to the applicability dates of the regulation on the basis of a claim that the assets of an insurer (other than plan assets held in a separate account) constitute plan assets. Notwithstanding the provisions of this paragraph (i)(1), this section shall not:

(i) Apply to an action brought by the Secretary of Labor pursuant to paragraphs (2) or (5) of section 502(a) of ERISA for a breach of fiduciary responsibility which would also constitute a

violation of Federal or State criminal law;

(ii) Preclude the application of any Federal criminal law; or

(iii) Apply to any civil action commenced before November 7, 1995.

(2) Nothing in this section relieves any person from any State law regulating insurance which imposes additional obligations or duties upon insurers to the extent not inconsistent with the provisions of this section. Therefore, nothing in this section should be construed to preclude a State from requiring insurers to make additional disclosures to policyholders, including plans. Nor does this section prohibit a State from imposing additional substantive requirements with respect to the management of general accounts or from otherwise regulating the relationship between the policyholder and the insurer to the extent not inconsistent with the provisions of this section.

(3) Nothing in this section precludes any claim against an insurer or other person for violations of the Act which do not require a finding that the underlying assets of a general account constitute plan assets, regardless of whether the violation relates to a Transition Policy.

(4) If the requirements in paragraphs (c) through (f) of this section are not met with respect to a plan that has purchased or acquired a Transition Policy, and the insurer has not cured the non-compliance through satisfaction of the requirements in paragraph (i)(5) of this section, the plan's assets include an undivided interest in the underlying assets of the insurer's general account for that period of time for which the requirements are not met. However, an insurer's failure to comply with the requirements of this section with respect to any particular Transition Policy will not result in the underlying assets of the general account constituting plan assets with respect to other Transition Policies if the insurer is otherwise in compliance with the requirements contained in this section.

(5) Notwithstanding paragraphs (a)(2) and (i)(4) of this section, a plan's assets will not include an undivided interest in the underlying assets of the insurer's general account if the insurer

made reasonable and good faith attempts at compliance with each of the requirements of paragraphs (c) through (f) of this section, and meets each of the following conditions:

(i) The insurer has in place written procedures that are reasonably designed to assure compliance with the requirements of paragraphs (c) through (f) of this section, including procedures reasonably designed to detect any instances of non-compliance.

(ii) No later than 60 days following the earlier of the insurer's detection of an instance of non-compliance or the receipt of written notice of non-compliance from the plan, the insurer complies with the requirements of paragraphs (c) through (f) of this section. If the insurer has failed to pay a plan the amounts required under paragraphs (e) or (f) of this section within 90 days of receiving written notice of termination or discontinuance of the policy, the insurer must make all corrections and adjustments necessary to restore to the plan the full amounts that the plan would have received but for the insurer's non-compliance within the applicable 60 day period; and

(iii) The insurer makes the plan whole for any losses resulting from the non-compliance as follows:

(A) If the insurer has failed to comply with the disclosure or notice requirements set forth in paragraphs (c), (d) and (f) of this section, then the insurer must make the plan whole for any losses resulting from its non-compliance within the earlier of 60 days of detection by the insurer or sixty days following the receipt of written notice from the plan; and

(B) If the insurer has failed to pay a plan any amounts required under paragraphs (e) or (f) of this section within 90 days of receiving written notice of termination or discontinuance of the policy, the insurer must pay to the plan interest on any amounts restored pursuant to paragraph (i)(5)(ii) of this section at the "underpayment rate" as set forth in 26 U.S.C. sections 6621 and 6622. Such interest must be paid within the earlier of 60 days of detection by the insurer or sixty days following receipt of written notice of non-compliance from the plan.

(j) *Applicability dates*—(1) *In general.* Except as provided in paragraphs (j)(2) through (4) of this section, this section is applicable on July 5, 2001.

(2) Paragraph (c) relating to initial disclosures and paragraph (d) relating to separate account disclosures are applicable on July 5, 2000.

(3) The first annual disclosure required under paragraph(c)(4) of this section shall be provided to each plan not later than 18 months following January 5, 2000.

(4) Paragraph (f), relating to insurer-initiated amendments, is applicable on January 5, 2000.

(k) *Effective date.* This section is effective January 5, 2000.

[65 FR 639, Jan. 5, 2000]

§ 2550.403a-1 Establishment of trust.

(a) *In general.* Except as otherwise provided in § 403b-1, all assets of an employee benefit plan shall be held in trust by one or more trustees pursuant to a written trust instrument.

(b) *Specific applications.* (1) The requirements of paragraph (a) of this section will not fail to be satisfied merely because securities of a plan are held in the name of a nominee or in street name, provided such securities are held on behalf of the plan by:

(i) A bank or trust company that is subject to supervision by the United States or a State, or a nominee of such bank or trust company;

(ii) A broker or dealer registered under the Securities Exchange Act of 1934, or a nominee of such broker or dealer; or

(iii) A "clearing agency," as defined in section 3(a)(23) of the Securities Exchange Act of 1934, or its nominee.

(2) Where a corporation described in section 501(c)(2) of the Internal Revenue Code holds property on behalf of a plan, the requirements of paragraph (a) of this section are satisfied with respect to such property if all the stock of such corporation is held in trust on behalf of the plan by one or more trustees.

(3) If the assets of an entity in which a plan invests include plan assets by reason of the plan's investment in the entity, the requirements of paragraph (a) of this section are satisfied with respect to such investment if the indicia

of ownership of the plan's interest in the entity are held in trust on behalf of the plan by one or more trustees.

(c) *Requirements concerning trustees.* The trustee or trustees referred to in paragraphs (a) and (b) shall be either named in the trust instrument or in the plan instrument described in section 402(a) of the Act, or appointed by a person who is a named fiduciary (within the meaning of section 402(a)(2) of the Act). Upon acceptance of being named or appointed, the trustee or trustees shall have exclusive authority and discretion to manage and control the assets of the plan, except to the extent that:

(1) The plan instrument or the trust instrument expressly provides that the trustee or trustees are subject to the direction of a named fiduciary who is not a trustee, in which case the trustees shall be subject to the proper directions of such fiduciary which are made in accordance with the terms of the plan and which are not contrary to the provisions of title I of the Act of chapter XXV of this title, or

(2) Authority to manage, acquire or dispose of assets of the plan is delegated to one or more investment managers (within the meaning of section 3(38) of the Act) pursuant to section 402(c)(3) of the Act.

[47 FR 21247, May 18, 1982]

§ 2550.403b-1 Exemptions from trust requirement.

(a) *Statutory exemptions.* The requirements of section 403(a) of the Act and section 403a-1 shall not apply—

(1) To any assets of a plan which consist of insurance contracts or policies issued by an insurance company qualified to do business in a State;

(2) To any assets of such an insurance company or any assets of a plan which are held by such an insurance company;

(3) To a plan—

(i) Some or all of the participants of which are employees described in section 401(c)(1) of the Internal Revenue Code of 1954; or

(ii) Which consists of one or more individual retirement accounts described in section 408 of the Internal Revenue Code of 1954. To the extent that such plan's assets are held in one or more

custodial accounts which qualify under section 401(f) or 408(h) of such Code, whichever is applicable;

(4) To a contract established and maintained under section 403(b) of the Internal Revenue Code of 1954 to the extent that the assets of the contract are held in one or more custodial accounts pursuant to section 403(b)(7) of such Code.

(5) To any plan, fund or program under which an employer, all of whose stock is directly or indirectly owned by employees, former employees or their beneficiaries, proposes through an unfunded arrangement to compensate retired employees for benefits which were forfeited by such employees under a pension plan maintained by a former employer prior to the date such pension plan became subject to the Act.

[47 FR 21247, May 18, 1982]

§ 2550.404a-1 Investment duties.

(a) *In general.* Section 404(a)(1)(B) of the Employee Retirement Income Security Act of 1974 (the Act) provides, in part, that a fiduciary shall discharge his duties with respect to a plan with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man 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.

(b) *Investment duties.* (1) With regard to an investment or investment course of action taken by a fiduciary of an employee benefit plan pursuant to his investment duties, the requirements of section 404(a)(1)(B) of the Act set forth in subsection (a) of this section are satisfied if the fiduciary:

(i) Has given appropriate consideration to those facts and circumstances that, given the scope of such fiduciary's investment duties, the fiduciary knows or should know are relevant to the particular investment or investment course of action involved, including the role the investment or investment course of action plays in that portion of the plan's investment portfolio with respect to which the fiduciary has investment duties; and

(ii) Has acted accordingly.

(2) For purposes of paragraph (b)(1) of this section, “appropriate consideration” shall include, but is not necessarily limited to,

(i) A determination by the fiduciary that the particular investment or investment course of action is reasonably designed, as part of the portfolio (or, where applicable, that portion of the plan portfolio with respect to which the fiduciary has investment duties), to further the purposes of the plan, taking into consideration the risk of loss and the opportunity for gain (or other return) associated with the investment or investment course of action, and

(ii) Consideration of the following factors as they relate to such portion of the portfolio:

(A) The composition of the portfolio with regard to diversification;

(B) The liquidity and current return of the portfolio relative to the anticipated cash flow requirements of the plan; and

(C) The projected return of the portfolio relative to the funding objectives of the plan.

(3) An investment manager appointed, pursuant to the provisions of section 402(c)(3) of the Act, to manage all or part of the assets of a plan, may, for purposes of compliance with the provisions of paragraphs (b)(1) and (2) of this section, rely on, and act upon the basis of, information pertaining to the plan provided by or at the direction of the appointing fiduciary, if—

(i) Such information is provided for the stated purpose of assisting the manager in the performance of his investment duties, and

(ii) The manager does not know and has no reason to know that the information is incorrect.

(c) *Definitions.* For purposes of this section:

(1) The term *investment duties* means any duties imposed upon, or assumed or undertaken by, a person in connection with the investment of plan assets which make or will make such person a fiduciary of an employee benefit plan or which are performed by such person as a fiduciary of an employee benefit plan as defined in section 3(21)(A)(i) or (ii) of the Act.

(2) The term *investment course of action* means any series or program of investments or actions related to a fiduciary’s performance of his investment duties.

(3) The term *plan* means an employee benefit plan to which title I of the Act applies.

[44 FR 37225, June 26, 1979]

§ 2550.404a-2 Safe harbor for automatic rollovers to individual retirement plans.

(a) *In general.* (1) Pursuant to section 657(c) of the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107-16, June 7, 2001, 115 Stat. 38, this section provides a safe harbor under which a fiduciary of an employee pension benefit plan subject to Title I of the Employee Retirement Income Security Act of 1974, as amended (the Act), 29 U.S.C. 1001 *et seq.*, will be deemed to have satisfied his or her fiduciary duties under section 404(a) of the Act in connection with an automatic rollover of a mandatory distribution described in section 401(a)(31)(B) of the Internal Revenue Code of 1986, as amended (the Code). This section also provides a safe harbor for certain other mandatory distributions not described in section 401(a)(31)(B) of the Code.

(2) The standards set forth in this section apply solely for purposes of determining whether a fiduciary meets the requirements of this safe harbor. Such standards are not intended to be the exclusive means by which a fiduciary might satisfy his or her responsibilities under the Act with respect to rollovers of mandatory distributions described in paragraphs (c) and (d) of this section.

(b) *Safe harbor.* A fiduciary that meets the conditions of paragraph (c) or paragraph (d) of this section is deemed to have satisfied his or her duties under section 404(a) of the Act with respect to both the selection of an individual retirement plan provider and the investment of funds in connection with the rollover of mandatory distributions described in those paragraphs to an individual retirement plan, within the meaning of section 7701(a)(37) of the Code.

(c) *Conditions.* With respect to an automatic rollover of a mandatory distribution described in section 401(a)(31)(B) of the Code, a fiduciary shall qualify for the safe harbor described in paragraph (b) of this section if:

(1) The present value of the non-forfeitable accrued benefit, as determined under section 411(a)(11) of the Code, does not exceed the maximum amount under section 401(a)(31)(B) of the Code;

(2) The mandatory distribution is to an individual retirement plan within the meaning of section 7701(a)(37) of the Code;

(3) In connection with the distribution of rolled-over funds to an individual retirement plan, the fiduciary enters into a written agreement with an individual retirement plan provider that provides:

(i) The rolled-over funds shall be invested in an investment product designed to preserve principal and provide a reasonable rate of return, whether or not such return is guaranteed, consistent with liquidity;

(ii) For purposes of paragraph (c)(3)(i) of this section, the investment product selected for the rolled-over funds shall seek to maintain, over the term of the investment, the dollar value that is equal to the amount invested in the product by the individual retirement plan;

(iii) The investment product selected for the rolled-over funds shall be offered by a state or federally regulated financial institution, which shall be: A bank or savings association, the deposits of which are insured by the Federal Deposit Insurance Corporation; a credit union, the member accounts of which are insured within the meaning of section 101(7) of the Federal Credit Union Act; an insurance company, the products of which are protected by State guaranty associations; or an investment company registered under the Investment Company Act of 1940;

(iv) All fees and expenses attendant to an individual retirement plan, including investments of such plan, (e.g., establishment charges, maintenance fees, investment expenses, termination costs and surrender charges) shall not exceed the fees and expenses charged

by the individual retirement plan provider for comparable individual retirement plans established for reasons other than the receipt of a rollover distribution subject to the provisions of section 401(a)(31)(B) of the Code; and

(v) The participant on whose behalf the fiduciary makes an automatic rollover shall have the right to enforce the terms of the contractual agreement establishing the individual retirement plan, with regard to his or her rolled-over funds, against the individual retirement plan provider.

(4) Participants have been furnished a summary plan description, or a summary of material modifications, that describes the plan's automatic rollover provisions effectuating the requirements of section 401(a)(31)(B) of the Code, including an explanation that the mandatory distribution will be invested in an investment product designed to preserve principal and provide a reasonable rate of return and liquidity, a statement indicating how fees and expenses attendant to the individual retirement plan will be allocated (*i.e.*, the extent to which expenses will be borne by the account holder alone or shared with the distributing plan or plan sponsor), and the name, address and phone number of a plan contact (to the extent not otherwise provided in the summary plan description or summary of material modifications) for further information concerning the plan's automatic rollover provisions, the individual retirement plan provider and the fees and expenses attendant to the individual retirement plan; and

(5) Both the fiduciary's selection of an individual retirement plan and the investment of funds would not result in a prohibited transaction under section 406 of the Act, unless such actions are exempted from the prohibited transaction provisions by a prohibited transaction exemption issued pursuant to section 408(a) of the Act.

(d) *Mandatory distributions of \$1,000 or less.* A fiduciary shall qualify for the protection afforded by the safe harbor described in paragraph (b) of this section with respect to a mandatory distribution of one thousand dollars (\$1,000) or less described in section 411(a)(11) of the Code, provided there is

no affirmative distribution election by the participant and the fiduciary makes a rollover distribution of such amount into an individual retirement plan on behalf of such participant in accordance with the conditions described in paragraph (c) of this section, without regard to the fact that such rollover is not described in section 401(a)(31)(B) of the Code.

(e) *Effective date.* This section shall be effective and shall apply to any rollover of a mandatory distribution made on or after March 28, 2005.

[69 FR 58028, Sept. 28, 2004]

§ 2550.404a-3 Safe harbor for distributions from terminated individual account plans.

(a) *General.* (1) This section provides a safe harbor under which a fiduciary (including a qualified termination administrator, within the meaning of § 2578.1(g) of this chapter) of a terminated individual account plan, as described in paragraph (a)(2) of this section, will be deemed to have satisfied its duties under section 404(a) of the Employee Retirement Income Security Act of 1974, as amended (the Act), 29 U.S.C. 1001 *et seq.*, in connection with a distribution described in paragraph (b) of this section.

(2) This section shall apply to an individual account plan only if—

(i) In the case of an individual account plan that is an abandoned plan within the meaning of § 2578.1 of this chapter, such plan was intended to be maintained as a tax-qualified plan in accordance with the requirements of section 401(a), 403(a), or 403(b) of the Internal Revenue Code of 1986 (Code); or

(ii) In the case of any other individual account plan, such plan is maintained in accordance with the requirements of section 401(a), 403(a), or 403 (b) of the Code at the time of the distribution.

(3) The standards set forth in this section apply solely for purposes of determining whether a fiduciary meets the requirements of this safe harbor. Such standards are not intended to be the exclusive means by which a fiduciary might satisfy his or her responsibilities under the Act with respect to making distributions described in this section.

(b) *Distributions.* This section shall apply to a distribution from a terminated individual account plan if, in connection with such distribution:

(1) The participant or beneficiary, on whose behalf the distribution will be made, was furnished notice in accordance with paragraph (e) of this section or, in the case of an abandoned plan, § 2578.1(d)(2)(vi) of this chapter, and

(2) The participant or beneficiary failed to elect a form of distribution within 30 days of the furnishing of the notice described paragraph (b)(1) of this section.

(c) *Safe harbor.* A fiduciary that meets the conditions of paragraph (d) of this section shall, with respect to a distribution described in paragraph (b) of this section, be deemed to have satisfied its duties under section 404(a) of the Act with respect to the distribution of benefits, selection of a transferee entity described in paragraph (d)(1)(i) through (iii) of this section, and the investment of funds in connection with the distribution.

(d) *Conditions.* A fiduciary shall qualify for the safe harbor described in paragraph (c) of this section if:

(1) The distribution described in paragraph (b) of this section is made—

(i) To an individual retirement plan within the meaning of section 7701(a)(37) of the Code;

(ii) In the case of a distribution on behalf of a designated beneficiary (as defined by section 401(a)(9)(E) of the Code) who is not the surviving spouse of the deceased participant, to an inherited individual retirement plan (within the meaning of section 402(c)(11) of the Code) established to receive the distribution on behalf of the nonspouse beneficiary; or

(iii) In the case of a distribution by a qualified termination administrator with respect to which the amount to be distributed is \$1000 or less and that amount is less than the minimum amount required to be invested in an individual retirement plan product offered by the qualified termination administrator to the public at the time of the distribution, to:

(A) An interest-bearing federally insured bank or savings association account in the name of the participant or beneficiary,

(B) The unclaimed property fund of the State in which the participant's or beneficiary's last known address is located, or

(C) An individual retirement plan (described in paragraph (d)(1)(i) or (d)(1)(ii) of this section) offered by a financial institution other than the qualified termination administrator to the public at the time of the distribution.

(2) Except with respect to distributions to State unclaimed property funds (described in paragraph (d)(1)(iii)(B) of this section), the fiduciary enters into a written agreement with the transferee entity which provides:

(i) The distributed funds shall be invested in an investment product designed to preserve principal and provide a reasonable rate of return, whether or not such return is guaranteed, consistent with liquidity (except that distributions under paragraph (d)(1)(iii)(A) of this section to a bank or savings account are not required to be invested in such a product);

(ii) For purposes of paragraph (d)(2)(i) of this section, the investment product shall—

(A) Seek to maintain, over the term of the investment, the dollar value that is equal to the amount invested in the product by the individual retirement plan (described in paragraph (d)(1)(i) or (d)(1)(ii) of this section), and

(B) Be offered by a State or federally regulated financial institution, which shall be: a bank or savings association, the deposits of which are insured by the Federal Deposit Insurance Corporation; a credit union, the member accounts of which are insured within the meaning of section 101(7) of the Federal Credit Union Act; an insurance company, the products of which are protected by State guaranty associations; or an investment company registered under the Investment Company Act of 1940;

(iii) All fees and expenses attendant to the transferee plan (described in paragraph (d)(1)(i) or (d)(1)(ii) of this section) or account (described in paragraph (d)(1)(iii)(A) of this section), including investments of such plan, (*e.g.*, establishment charges, maintenance fees, investment expenses, termination

costs and surrender charges), shall not exceed the fees and expenses charged by the provider of the plan or account for comparable plans or accounts established for reasons other than the receipt of a distribution under this section; and

(iv) The participant or beneficiary on whose behalf the fiduciary makes a distribution shall have the right to enforce the terms of the contractual agreement establishing the plan (described in paragraph (d)(1)(i) or (d)(1)(ii) of this section) or account (described in paragraph (d)(1)(iii)(A) of this section), with regard to his or her transferred account balance, against the plan or account provider.

(3) Both the fiduciary's selection of a transferee plan (described in paragraph (d)(1)(i) or (d)(1)(ii) of this section) or account (described in paragraph (d)(1)(iii)(A) of this section) and the investment of funds would not result in a prohibited transaction under section 406 of the Act, unless such actions are exempted from the prohibited transaction provisions by a prohibited transaction exemption issued pursuant to section 408(a) of the Act.

(e) *Notice to participants and beneficiaries*—(1) *Content*. Each participant or beneficiary of the plan shall be furnished a notice written in a manner calculated to be understood by the average plan participant and containing the following:

(i) The name of the plan;

(ii) A statement of the account balance, the date on which the amount was calculated, and, if relevant, an indication that the amount to be distributed may be more or less than the amount stated in the notice, depending on investment gains or losses and the administrative cost of terminating the plan and distributing benefits;

(iii) A description of the distribution options available under the plan and a request that the participant or beneficiary elect a form of distribution and inform the plan administrator (or other fiduciary) identified in paragraph (e)(1)(vii) of this section of that election;

(iv) A statement explaining that, if a participant or beneficiary fails to make an election within 30 days from

receipt of the notice, the plan will distribute the account balance of the participant or beneficiary to an individual retirement plan (i.e., individual retirement account or annuity described in paragraph (d)(1)(i) or (d)(1)(ii) of this section) and the account balance will be invested in an investment product designed to preserve principal and provide a reasonable rate of return and liquidity;

(v) A statement explaining what fees, if any, will be paid from the participant or beneficiary's individual retirement plan (described in paragraph (d)(1)(i) or (d)(1)(ii) of this section), if such information is known at the time of the furnishing of this notice;

(vi) The name, address and phone number of the individual retirement plan (described in paragraph (d)(1)(i) or (d)(1)(ii) of this section) provider, if such information is known at the time of the furnishing of this notice; and

(vii) The name, address, and telephone number of the plan administrator (or other fiduciary) from whom a participant or beneficiary may obtain additional information concerning the termination.

(2) *Manner of furnishing notice.* (i) For purposes of paragraph (e)(1) of this sec-

tion, a notice shall be furnished to each participant or beneficiary in accordance with the requirements of § 2520.104b-1(b)(1) of this chapter to the last known address of the participant or beneficiary; and

(ii) In the case of a notice that is returned to the plan as undeliverable, the plan fiduciary shall, consistent with its duties under section 404(a)(1) of ERISA, take steps to locate the participant or beneficiary and provide notice prior to making the distribution. If, after such steps, the fiduciary is unsuccessful in locating and furnishing notice to a participant or beneficiary, the participant or beneficiary shall be deemed to have been furnished the notice and to have failed to make an election within 30 days for purposes of paragraph (b)(2) of this section.

(f) *Model notice.* The appendix to this section contains a model notice that may be used to discharge the notification requirements under this section. Use of the model notice is not mandatory. However, use of an appropriately completed model notice will be deemed to satisfy the requirements of paragraph (e)(1) of this section.

APPENDIX TO § 2550.404a-3

NOTICE OF PLAN TERMINATION

[*Date of notice*]

[*Name and last known address of plan participant or beneficiary*]

Re: [*Name of plan*]

Dear [*Name of plan participant or beneficiary*]:

This notice is to inform you that [*name of the plan*] (the Plan) has been terminated and we are in the process of winding it up.

We have determined that you have an interest in the Plan, either as a plan participant or beneficiary. Your account balance in the Plan on [*date*] is/was [*account balance*]. We will be distributing this money as permitted under the terms of the Plan and federal regulations. *{If applicable, insert the following sentence: The actual amount of your distribution may be more or less than the amount stated in this notice depending on investment gains or losses and the administrative cost of terminating your plan and distributing your benefits.}*

Your distribution options under the Plan are *{add a description of the Plan's distribution options}*. It is very important that you elect one of these forms of distribution and inform us of your election. The process for informing us of this election is *{enter a description of the Plan's election process}*.

If you do not make an election within 30 days from your receipt of this notice, your account balance will be transferred directly to an individual retirement plan (inherited individual retirement plan in the case of a nonspouse beneficiary). *{If the name of the provider of the individual retirement plan is known, include the following sentence: The name of the provider of the individual retirement plan is [*name, address and phone number of the individual retirement plan provider*].}* Pursuant to federal law, your money in the individual retirement plan would then be invested in an investment product designed to preserve principal and provide a reasonable rate of return and liquidity. *{If fee information is known, include the following sentence: Should your money be transferred into an individual retirement plan, [*name of the financial institution*] charges the following fees for its services: *{add a statement of fees, if any, that will be paid from the participant or beneficiary's individual retirement plan}*.}*

For more information about the termination, your account balance, or distribution options, please contact [*name, address, and telephone number of the plan administrator or other appropriate contact person*].

Sincerely,
[*Name of plan administrator or appropriate designee*]

[71 FR 20850, Apr. 21, 2006; 71 FR 29219, May 19, 2006; 72 FR 7520, Feb. 15, 2007; 73 FR 58463, Oct. 7, 2008]

§ 2550.404a-4 Selection of annuity providers—safe harbor for individual account plans.

(a) *Scope.* (1) This section establishes a safe harbor for satisfying the fiduciary duties under section 404(a)(1)(B) of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1104-1114, in selecting an annuity provider and contract for benefit distributions from an individual account plan. For guidance concerning the selection of an annuity provider for defined benefit plans see 29 CFR 2509.95-1.

(2) This section sets forth an optional means for satisfying the fiduciary responsibilities under section 404(a)(1)(B) of ERISA with respect to the selection of an annuity provider or contract for benefit distributions. This section does not establish minimum requirements or the exclusive means for satisfying these responsibilities.

(b) *Safe harbor.* The selection of an annuity provider for benefit distributions from an individual account plan satisfies the requirements of section 404(a)(1)(B) of ERISA if the fiduciary:

(1) Engages in an objective, thorough and analytical search for the purpose of identifying and selecting providers from which to purchase annuities;

(2) Appropriately considers information sufficient to assess the ability of the annuity provider to make all future payments under the annuity contract;

(3) Appropriately considers the cost (including fees and commissions) of the annuity contract in relation to the benefits and administrative services to be provided under such contract;

(4) Appropriately concludes that, at the time of the selection, the annuity provider is financially able to make all future payments under the annuity contract and the cost of the annuity contract is reasonable in relation to the benefits and services to be provided under the contract; and

(5) If necessary, consults with an appropriate expert or experts for purposes of compliance with the provisions of this paragraph (b).

(c) *Time of selection.* For purposes of paragraph (b) of this section, the “time of selection” may be either:

(1) The time that the annuity provider and contract are selected for distribution of benefits to a specific participant or beneficiary; or

(2) The time that the annuity provider is selected to provide annuity contracts at future dates to participants or beneficiaries, provided that the selecting fiduciary periodically reviews the continuing appropriateness of the conclusion described in paragraph (b)(4) of this section, taking into account the factors described in paragraphs (b)(2), (3) and (5) of this section. For purposes of this paragraph (c)(2), a fiduciary is not required to review the appropriateness of this conclusion with respect to any annuity contract purchased for any specific participant or beneficiary.

[73 FR 58449, Oct. 7, 2008]

§ 2550.404b-1 Maintenance of the indicia of ownership of plan assets outside the jurisdiction of the district courts of the United States.

(a) No fiduciary may maintain the indicia of ownership of any assets of a plan outside the jurisdiction of the district courts of the United States, unless:

(1) Such assets are:

(i) Securities issued by a person, as defined in section 3(9) of the Employee Retirement Income Security Act of 1974 (Act) (other than an individual), which is not organized under the laws of the United States or a State and does not have its principal place of business within the United States;

(ii) Securities issued by a government other than the government of the United States or of a State, or any political subdivision, agency or instrumentality of such a government;

(iii) Securities issued by a person, as defined in section 3(9) of the Act (other than an individual), the principal trading market for which securities is outside the jurisdiction of the district courts of the United States; or

(iv) Currency issued by a government other than the government of the United States if such currency is maintained outside the jurisdiction of the district courts of the United States

solely as an incident to the purchase, sale or maintenance of securities described in paragraph (a)(1) of this section; and

(2)(i) Such assets are under the management and control of a fiduciary which is a corporation or partnership organized under the laws of the United States or a State, which fiduciary has its principal place of business within the United States and which is—

(A) A bank as defined in section 202(a)(2) of the Investment Advisers Act of 1940 that has, as of the last day of its most recent fiscal year, equity capital in excess of \$1,000,000;

(B) An insurance company which is qualified under the laws of more than one State to manage, acquire, or dispose of any asset of a plan, which company has, as of the last day of its most recent fiscal year, net worth in excess of \$1,000,000 and which is subject to supervision and examination by the State authority having supervision over insurance companies; or

(C) An investment adviser registered under the Investment Advisers Act of 1940 that has, as of the last day of its most recent fiscal year, total client assets under its management and control in excess \$50,000,000 and either

(1) Shareholders' or partners' equity in excess of \$750,000 or

(2) All of its obligations and liabilities assumed or guaranteed by a person described in paragraph (a)(2)(i)(A), (B), or (C)(1) or (a)(2)(ii)(A)(2) of this section; or

(ii) Such indicia of ownership are either

(A) In the physical possession of, or, as a result of normal business operations, are in transit to the physical possession of, a person which is organized under the laws of the United States or a State, which person has its principal place of business in the United States and which is—

(1) A bank as defined in section 202(a)(2) of the Investment Advisers Act of 1940 that has, as of the last day of its most recent fiscal year, equity capital in excess of \$1,000,000;

(2) A broker or dealer registered under the Securities Exchange Act of 1934 that has, as of the last day of its most recent fiscal year, net worth in excess of \$750,000; or

(3) A broker or dealer registered under the Securities Exchange Act of 1934 that has all of its obligations and liabilities assumed or guaranteed by a person described in paragraph (a)(2)(i)(A), (B), or (C)(1) or (a)(2)(ii)(A)(2) of this section; or

(B) Maintained by a broker or dealer, described in paragraph (a)(2)(ii)(A)(2) or (3) of this section, in the custody of an entity designated by the Securities and Exchange Commission as a "satisfactory control location" with respect to such broker or dealer pursuant to Rule 15c3-3 under the Securities Exchange Act of 1934, provided that:

(1) Such entity holds the indicia of ownership as agent for the broker or dealer, and

(2) Such broker or dealer is liable to the plan to the same extent it would be if it retained the physical possession of the indicia of ownership pursuant to paragraph (a)(2)(ii)(A) of this section.

(C) Maintained by a bank described in paragraph (a)(2)(ii)(A)(1), in the custody of an entity that is a foreign securities depository, foreign clearing agency which acts as a securities depository, or foreign bank, which entity is supervised or regulated by a government agency or regulatory authority in the foreign jurisdiction having authority over such depositories, clearing agencies or banks, provided that:

(1) The foreign entity holds the indicia of ownership as agent for the bank;

(2) The bank is liable to the plan to the same extent it would be if it retained the physical possession of the indicia of ownership within the United States;

(3) The indicia of ownership are not subject to any right, charge, security interest, lien or claim of any kind in favor of the foreign entity except for their safe custody or administration;

(4) Beneficial ownership of the assets represented by the indicia of ownership is freely transferable without the payment of money or value other than for safe custody or administration; and

(5) Upon request by the plan fiduciary who is responsible for the selection and retention of the bank, the bank identifies to such fiduciary the name, address and principal place of business of the foreign entity which acts as custodian for the plan pursuant

to this paragraph (a)(2)(ii)(C), and the name and address of the governmental agency or other regulatory authority that supervises or regulates that foreign entity.

(b) Notwithstanding any requirement of paragraph (a) of this section, a fiduciary with respect to a plan may maintain in Canada the indicia of ownership of plan assets which are attributable to a contribution made on behalf of a plan participant who is a citizen or resident of Canada, if such indicia of ownership must remain in Canada in order for the plan to qualify for and maintain tax exempt status under the laws of Canada or to comply with other applicable laws of Canada or any Province of Canada.

(c) For purposes of this regulation:

(1) The term *management and control* means the power to direct the acquisition or disposition through purchase, sale, pledging, or other means; and

(2) The term *depository* means any company, or agency or instrumentality of government, that acts as a custodian of securities in connection with a system for the central handling of securities whereby all securities of a particular class or series of any issuer deposited within the system are treated as fungible and may be transferred, loaned, or pledged by bookkeeping entry without physical delivery of securities certificates.

[42 FR 54124, Oct. 4, 1977, as amended at 46 FR 1267, Jan. 6, 1981]

§ 2550.404c-1 ERISA section 404(c) plans.

(a) *In general.* (1) Section 404(c) of the Employee Retirement Income Security Act of 1974 (ERISA or the Act) provides that if a pension plan that provides for individual accounts permits a participant or beneficiary to exercise control over assets in his account and that participant or beneficiary in fact exercises control over assets in his account, then the participant or beneficiary shall not be deemed to be a fiduciary by reason of his exercise of control and no person who is otherwise a fiduciary shall be liable for any loss, or by reason of any breach, which results from such exercise of control. This section describes the kinds of plans that are "ERISA section 404(c) plans," the cir-

cumstances in which a participant or beneficiary is considered to have exercised independent control over the assets in his account as contemplated by section 404(c), and the consequences of a participant's or beneficiary's exercise of control.

(2) The standards set forth in this section 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). Such standards, therefore, are not intended to be applied in determining whether, or to what extent, a plan which does not meet the requirements for an ERISA section 404(c) plan or a fiduciary with respect to such a plan satisfies the fiduciary responsibility or other provisions of title I of the Act.

(b) *ERISA section 404(c) plans*—(1) *In general.* An "ERISA section 404(c) Plan" is an individual account plan described in section 3(34) of the Act that:

(i) Provides an opportunity for a participant or beneficiary to exercise control over assets in his individual account (see paragraph (b)(2) of this section); 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 account are invested (see paragraph (b)(3) of this section).

(2) *Opportunity to exercise control.* (i) a plan provides a participant or beneficiary an opportunity to exercise control over assets in his account only if:

(A) Under the terms of the plan, the participant or beneficiary has a reasonable opportunity to give investment instructions (in writing or otherwise, with opportunity to obtain written confirmation of such instructions) to an identified plan fiduciary who is obligated to comply with such instructions except as otherwise provided in paragraph (b)(2)(ii)(B) and (d)(2)(ii) of this section; and

(B) The participant or beneficiary is provided or has 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. For purposes of this subparagraph, a participant or beneficiary will not be considered to have sufficient investment information unless—

(1) The participant or beneficiary is provided by an identified plan fiduciary (or a person or persons designated by the plan fiduciary to act on his behalf):

(i) An explanation that the plan is intended to constitute a plan described in section 404(c) of the Employee Retirement Income Security Act, and title 29 of the Code of Federal Regulations, § 2550.440c-1, and that the fiduciaries of the plan may be relieved of liability for any losses which are the direct and necessary result of investment instructions given by such participant or beneficiary;

(ii) A description of the investment alternatives available under the plan and, with respect to each designated investment alternative, a general description of the investment objectives and risk and return characteristics of each such alternative, including information relating to the type and diversification of assets comprising the portfolio of the designed investment alternative;

(iii) Identification of any designated investment managers;

(iv) An explanation of the circumstances under which participants and beneficiaries may give investment instructions and explanation of any specified limitations on such instructions under the terms of the plan, including any restrictions on transfer to or from a designated investment alternative, and any restrictions on the exercise of voting, tender and similar rights appurtenant to a participant's or beneficiary's investment in an investment alternative;

(v) A description of any transaction fees and expenses which affect the participant's or beneficiary's account balance in connection with purchases or sales of interests in investment alternatives (e.g., commissions, sales load, deferred sales charges, redemption or exchange fees);

(vi) The name, address, and phone number of the plan fiduciary (and, if applicable, the person or persons designated by the plan fiduciary to act on

his behalf) responsible for providing the information described in paragraph (b)(2)(i)(B)(2) upon request of a participant or beneficiary and a description of the information described in paragraph (b)(2)(i)(B)(2) which may be obtained on request;

(vii) In the case of plans which offer an investment alternative which is designed to permit a participant or beneficiary to directly or indirectly acquire or sell any employer security (employer security alternative), a description of the procedures established to provide for the confidentiality of information relating to the purchase, holding and sale of employer securities, 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 the procedures (see paragraphs (d)(2)(ii)(E)(4)(vii), (viii) and (ix) of this section); and

(viii) In the case of an investment alternative which is subject to the Securities Act of 1933, and in which the participant or beneficiary has no assets invested, immediately following the participant's or beneficiary's initial investment, a copy of the most recent prospectus provided to the plan. This condition will be deemed satisfied if the participant or beneficiary has been provided with a copy of such most recent prospectus immediately prior to the participant's or beneficiary's initial investment in such alternative;

(ix) Subsequent to an investment in an investment alternative, any materials provided to the plan relating to the exercise of voting, tender or similar rights which are incidental to the holding in the account of the participant or beneficiary of an ownership interest in such alternative to the extent that such rights are passed through to participants and beneficiaries under the terms of the plan, as well as a description of or reference to plan provisions relating to the exercise of voting, tender or similar rights.

(2) The participants or beneficiary is provided by the identified plan fiduciary (or a person or persons designated by the plan fiduciary to act on his behalf), either directly or upon request, the following information, which

shall be based on the latest information available to the plan:

(i) A description of the annual operating expenses of each designated investment alternative (e.g., investment management fees, administrative fees, transaction costs) which reduce the rate of return to participants and beneficiaries, and the aggregate amount of such expenses expressed as a percentage of average net assets of the designated investment alternative;

(ii) Copies of any prospectuses, financial statements and reports, and of any other materials relating to the investment alternatives available under the plan, to the extent such information is provided to the plan;

(iii) A list of the assets comprising the portfolio of each designated investment alternative which constitute plan assets within the meaning of 29 CFR 2510.3-101, the value of each such asset (or the proportion of the investment alternative which it comprises), and, with respect to each such asset which is a fixed rate investment contract issued by a bank, savings and loan association or insurance company, the name of the issuer of the contract, the term of the contract and the rate of return on the contract;

(iv) Information concerning the value of shares or units in designated investment alternatives available to participants and beneficiaries under the plan, as well as the past and current investment performance of such alternatives, determined, net of expenses, on a reasonable and consistent basis; and

(v) Information concerning the value of shares or units in designated investment alternatives held in the account of the participant or beneficiary.

(ii) A plan does not fail to provide an opportunity for a participant or beneficiary to exercise control over his individual account merely because it—

(A) *Imposes charges for reasonable expenses.* A plan may charge participants' and beneficiaries' accounts for the reasonable expenses of carrying out investment instructions, provided that procedures are established under the plan to periodically inform such participants and beneficiaries of actual expenses incurred with respect to their respective individual accounts;

(B) *Permits a fiduciary to decline to implement investment instructions by participants and beneficiaries.* A fiduciary may decline to implement participant and beneficiary instructions which are described at paragraph (d)(2)(ii) of this section, as well as instructions specified in the plan, including instructions—

(1) Which would result in a prohibited transaction described in ERISA section 406 or section 4975 of the Internal Revenue Code, and

(2) Which would generate income that would be taxable to the plan;

(C) *Imposes reasonable restrictions on frequency of investment instructions.* A plan may impose reasonable restrictions on the frequency with which participants and beneficiaries may give investment instructions. In no event, however, is such a restriction reasonable unless, with respect to each investment alternative made available by the plan, it permits participants and beneficiaries to give investment instructions with a frequency which is appropriate in light of the market volatility to which the investment alternative may reasonably be expected to be subject, provided that—

(1) At least three of the investment alternatives made available pursuant to the requirements of paragraph (b)(3)(i)(B) of this section, which constitute a broad range of investment alternatives, Permit participants and beneficiaries to give investment instructions no less frequently than once within any three month period; and

(2)(i) At least one of the investment alternatives meeting the requirements of paragraph (b)(2)(ii)(C)(1) of this section permits participants and beneficiaries to give investment instructions with regard to transfers into the investment alternative as frequently as participants and beneficiaries are permitted to give investment instructions with respect to any investment alternative made available by the plan which permits participants and beneficiaries to give investment instructions more frequently than once within any three month period; or

(ii) With respect to each investment alternative which permits participants and beneficiaries to give investment instructions more frequently than once

within any three month period, participants and beneficiaries are permitted to direct their investments from such alternative into an income producing, low risk, liquid fund, subfund, or account as frequently as they are permitted to give investment instructions with respect to each such alternative and, with respect to such fund, subfund or account, participants and beneficiaries are permitted to direct investments from the fund, subfund or account to an investment alternative meeting the requirements of paragraph (b)(2)(ii)(C)(I) as frequently as they are permitted to give investment instructions with respect to that investment alternative; and

(3) With respect to transfers from an investment alternative which is designed to permit a participant or beneficiary to directly or indirectly acquire or sell any employer security (employer security alternative) either:

(i) All of the investment alternatives meeting the requirements of paragraph (b)(2)(ii)(C)(I) of this section must permit participants and beneficiaries to give investment instructions with regard to transfers into each of the investment alternatives as frequently as participants and beneficiaries are permitted to give investment instructions with respect to the employer security alternative; or

(ii) Participants and beneficiaries are permitted to direct their investments from each employer security alternative into an income producing, low risk, liquid fund, subfund, or account as frequently as they are permitted to give investment instructions with respect to such employer security alternative and, with respect to such fund, subfund, or account, participants and beneficiaries are permitted to direct investments from the fund, subfund or account to each investment alternative meeting the requirements of paragraph (b)(2)(ii)(C)(I) as frequently as they are permitted to give investment instructions with respect to each such investment alternative.

(iii) Paragraph (c) of this section describes the circumstances under which a participant or beneficiary will be considered to have exercised independent control with respect to a particular transaction.

(3) *Broad range of investment alternatives.* (i) A plan offers a broad range of investment alternatives only if the available investment alternatives are sufficient to provide the participant or beneficiary with a reasonable opportunity to:

(A) Materially affect the potential return on amounts in his individual account with respect to which he is permitted to exercise control and the degree of risk to which such amounts are subject;

(B) Choose from at least three investment alternatives:

(1) Each of which is diversified;

(2) Each of which has materially different risk and return characteristics;

(3) Which in the aggregate enable the participant or beneficiary by choosing among them to achieve a portfolio with aggregate risk and return characteristics at any point within the range normally appropriate for the participant or beneficiary; and

(4) Each of which when combined with investments in the other alternatives tends to minimize through diversification the overall risk of a participant's or beneficiary's portfolio;

(C) Diversify the investment of that portion of his individual account with respect to which he is permitted to exercise control so as to minimize the risk of large losses, taking into account the nature of the plan and the size of participants' or beneficiaries' accounts. In determining whether a plan provides the participant or beneficiary with a reasonable opportunity to diversify his investments, the nature of the investment alternatives offered by the plan and the size of the portion of the individual's account over which he is permitted to exercise control must be considered. Where such portion of the account of any participant or beneficiary is so limited in size that the opportunity to invest in look-through investment vehicles is the only prudent means to assure an opportunity to achieve appropriate diversification, a plan may satisfy the requirements of this paragraph only by offering look-through investment vehicles.

(ii) *Diversification and look-through investment vehicles.* Where look-through

investment vehicles are available as investment alternatives to participants and beneficiaries, the underlying investments of the look-through investment vehicles shall be considered in determining whether the plan satisfies the requirements of subparagraphs (b)(3)(i)(B) and (b)(3)(i)(C).

(c) *Exercise of control*—(1) *In general.*

(i) Sections 404(c)(1) and 404(c)(2) of the Act and paragraphs (a) and (d) of this section apply 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 individual account under an ERISA section 404(c) plan.

(ii) For purposes of sections 404(c)(1) and 404(c)(2) of the Act and paragraphs (a) and (d) of this section, a participant or beneficiary will be deemed to have exercised control with respect to the exercise of voting, tender and similar rights appurtenant to the participant's or beneficiary's ownership interest in an investment alternative, provided that the participant's or beneficiary's investment in the investment alternative was itself the result of an exercise of control, the participant or beneficiary was provided a reasonable opportunity to give instruction with respect to such incidents of ownership, including the provision of the information described in paragraph (b)(2)(i)(B)(I)(ix) of this section, and the participant or beneficiary has not failed to exercise control by reason of the circumstances described in paragraph (c)(2) with respect to such incidents of ownership.

(2) *Independent control.* Whether a participant or beneficiary has exercised independent control in fact with respect to a transaction depends on the facts and circumstances of the particular case. However, a participant's or beneficiary's exercise of control is not independent in fact if:

(i) The participant or beneficiary is subjected to improper influence by a plan fiduciary or the plan sponsor with respect to the transaction;

(ii) A plan fiduciary has concealed material non-public facts regarding the investment from the participant or beneficiary, unless the disclosure of such information by the plan fiduciary

to the participant or beneficiary would violate any provision of federal law or any provision of state law which is not preempted by the Act; or

(iii) The participant or beneficiary is legally incompetent and the responsible plan fiduciary accepts the instructions of the participant or beneficiary knowing him to be legally incompetent.

(3) *Transactions involving a fiduciary.*

In the case of a sale, exchange or leasing of property (other than a transaction described in paragraph (d)(2)(ii)(E) of this section) between an ERISA section 404(c) plan and a plan fiduciary or an affiliate of such a fiduciary, or a loan to a plan fiduciary or an affiliate of such a fiduciary, the participant or beneficiary will not be deemed to have exercised independent control unless the transaction is fair and reasonable to him. For purposes of this paragraph (c)(3), a transaction will be deemed to be fair and reasonable to a participant or beneficiary if he pays no more than, or receives no less than, adequate consideration (as defined in section 3(18) of the Act) in connection with the transaction.

(4) *No obligation to advise.* A fiduciary has no obligation under part 4 of title I of the Act to provide investment advice to a participant or beneficiary under an ERISA section 404(c) plan.

(d) *Effect of independent exercise of control*—(1) *Participant or beneficiary not a fiduciary.* If a participant or beneficiary of an ERISA section 404(c) plan exercises independent control over assets in his individual account in the manner described in paragraph (c), then such participant or beneficiary is not a fiduciary of the plan by reason of such exercise of control.

(2) *Limitation on liability of plan fiduciaries.* (i) If a participant or beneficiary of an ERISA section 404(c) plan exercises independent control over assets in his individual account in the manner described in paragraph (c), then no other person who is a fiduciary with respect to such plan shall be liable for any loss, or with respect to any breach of part 4 of title I of the Act, that is the direct and necessary result of that participant's or beneficiary's exercise of control.

(ii) Paragraph (d)(2)(i) does not apply with respect to any instruction, which if implemented—

(A) Would not be in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of title I of ERISA;

(B) Would cause a fiduciary to maintain the indicia of ownership of any assets of the plan outside the jurisdiction of the district courts of the United States other than as permitted by section 404(b) of the Act and 29 CFR 2550.404b-1;

(C) Would jeopardize the plan's tax qualified status under the Internal Revenue Code;

(D) Could result in a loss in excess of a participant's or beneficiary's account balance; or

(E) Would result in a direct or indirect:

(1) Sale, exchange, or lease of property between a plan sponsor or any affiliate of the sponsor and the plan except for the acquisition or disposition of any interest in a fund, subfund or portfolio managed by a plan sponsor or an affiliate of the sponsor, or the purchase or sale of any qualifying employer security (as defined in section 407(d)(5) of the Act) which meets the conditions of section 408(e) of ERISA and section (d)(2)(ii)(E)(4) below;

(2) Loan to a plan sponsor or any affiliate of the sponsor;

(3) Acquisition or sale of any employer real property (as defined in section 407(d)(2) of the Act); or

(4) Acquisition or sale of any employer security except to the extent that:

(i) Such securities are qualifying employer securities (as defined in section 407(d)(5) of the Act);

(ii) Such securities are stock or an equity interest in a publicly traded partnership (as defined in section 7704(b) of the Internal Revenue Code of 1986), but only if such partnership is an existing partnership as defined in section 10211(c)(2)(A) of the Revenue Act of 1987 (Public Law 100-203);

(iii) Such securities are publicly traded on a national exchange or other generally recognized market;

(iv) Such securities are traded with sufficient frequency and in sufficient

volume to assure that participant and beneficiary directions to buy or sell the security may be acted upon promptly and efficiently;

(v) Information provided to shareholders of such securities is provided to participants and beneficiaries with accounts holding such securities;

(vi) Voting, tender and similar rights with respect to such securities are passed through to participants and beneficiaries with accounts holding such securities;

(vii) Information relating to the purchase, holding, and sale of securities, and the exercise of voting, tender and similar rights with respect to such securities by participants and beneficiaries, is maintained in accordance with procedures which are designed to safeguard the confidentiality of such information, except to the extent necessary to comply with Federal laws or state laws not preempted by the Act;

(viii) The plan designates a fiduciary who is responsible for ensuring that: The procedures required under subparagraph (d)(2)(ii)(E)(4)(vii) are sufficient to safeguard the confidentiality of the information described in that subparagraph, such procedures are being followed, and the independent fiduciary required by subparagraph (d)(2)(ii)(E)(4)(ix) is appointed; and

(ix) An independent fiduciary is appointed to carry out activities relating to any situations which the fiduciary designated by the plan for purposes of subparagraph (d)(2)(ii)(E)(4)(viii) determines involve a potential for undue employer influence upon participants and beneficiaries with regard to the direct or indirect exercise of shareholder rights. For purposes of this subparagraph, a fiduciary is not independent if the fiduciary is affiliated with any sponsor of the plan.

(iii) The individual investment decisions of an investment manager who is designated directly by a participant or beneficiary or who manages a look-through investment vehicle in which a participant or beneficiary has invested are not direct and necessary results of the designation of the investment manager or of investment in the look-through investment vehicle. However, this paragraph (d)(2)(iii) shall not be construed to result in liability under

section 405 of ERISA with respect to a fiduciary (other than the investment manager) who would otherwise be relieved of liability by reason of section 404(c)(2) of the Act and paragraph (d) of this section.

(3) *Prohibited transactions.* The relief provided by section 404(c) of the Act and this section applies only to the provisions of part 4 of title I of the Act. Therefore, nothing in this section relieves a disqualified person from the taxes imposed by sections 4975 (a) and (b) of the Internal Revenue Code with respect to the transactions prohibited by section 4975(c)(1) of the Code.

(e) *Defintions.* For purposes of this section:

(1) *Look-through investment vehicle* means:

(i) An investment company described in section 3(a) of the Investment Company Act of 1940, or a series investment company described in section 18(f) of the 1940 Act or any of the segregated portfolios of such company;

(ii) A common or collective trust fund or a pooled investment fund maintained by a bank or similar institution, a deposit in a bank or similar institution, or a fixed rate investment contract of a bank or similar institution;

(iii) A pooled separate account or a fixed rate investment contract of an insurance company qualified to do business in a State; or

(iv) Any entity whose assets include plan assets by reason of a plan's investment in the entity;

(2) *Adequate consideration* has the meaning given it in section 3(18) of the Act and in any regulations under this title;

(3) An *affiliate* of a person includes the following:

(i) Any person directly or indirectly controlling, controlled by, or under common control with the person;

(ii) Any officer, director, partner, employee, an employee of an affiliated employer, relative (as defined in section 3(15) of ERISA), brother, sister, or spouse of a brother or sister, of the person; and

(iii) Any corporation or partnership of which the person is an officer director or partner.

For purposes of this paragraph (e)(3), the term "control" means, with re-

spect to a person other than an individual, the power to exercise a controlling influence over the management or policies of such person.

(4) A *designated investment alternative* is a specific investment identified by a plan fiduciary as an available investment alternative under the plan.

(f) *Examples.* The provisions of this section are illustrated by the following examples. Examples (5) through (11) assume that the participant has exercised independent control with respect to his individual account under an ERISA section 404(c) plan described in paragraph (b) and has not directed a transaction described in paragraph (d)(2)(ii).

(1) Plan A is an individual account plan described in section 3(34) of the Act. The plan states that a plan participant or beneficiary may direct the plan administrator to invest any portion of his individual account in a particular diversified equity fund managed by an entity which is not affiliated with the plan sponsor, or any other asset administratively feasible for the plan to hold. However, the plan provides that the plan administrator will not implement certain listed instructions for which plan fiduciaries would not be relieved of liability under section 404(c) (see paragraph (d)(2)(ii)). Plan participants and beneficiaries are permitted to give investment instructions during the first week of each month with respect to the equity fund and at any time with respect to other investments. The plan provides for the pass-through of voting, tender and similar rights incidental to the holding in the account of a participant or beneficiary of an ownership interest in the equity fund or any other investment alternative available under the plan. The plan administrator of plan A provides each participant and beneficiary with the information described in subparagraphs (i), (ii), (iii), (iv), (v), (vi) and (vii) of paragraph (b)(2)(i)(B)(I) upon their entry into the plan, and provides updated information in the event of any material change in the information provided. Immediately following an investment by a participant or beneficiary in the equity fund, the plan administrator provides a copy of the most recent prospectus received from the fund to the investing participant or beneficiary. Immediately following any investment by a participant or beneficiary in any other investment alternative which is subject to the Securities Act of 1933, the plan administrator provides the participant or beneficiary with the most recent prospectus received from that investment alternative (see paragraph (b)(2)(i)(B)(I)(viii)). Finally, subsequent to any investment by a participant or

beneficiary, the plan administrator forwards to the investing participant or beneficiary any materials provided to the plan relating to the exercise of voting, tender or similar rights attendant to ownership of an interest in such investment (see paragraph (b)(2)(i)(B)(I)(ix)). Upon request, the plan administrator provides each participant or beneficiary with copies of any prospectuses, financial statements and reports, and any other materials relating to the investment alternatives available under the plan which are received by the plan (see paragraph (b)(2)(i)(B)(2)(ii)). Also upon request, the plan administrator provides each participant and beneficiary with the other information required by paragraph (b)(2)(i)(B)(2) with respect to the equity fund, which is a designated investment alternative, including information concerning the latest available value of the participant's or beneficiary's interest in the equity fund (see paragraph (b)(2)(i)(B)(2)(v)). Plan A meets the requirements of paragraphs (b)(2)(i)(B)(I) and (2) of this section regarding the provision of investment information.

NOTE: The regulation imposes no additional obligation on the administrator to furnish or make available materials relating to the companies in which the equity fund invests (e.g., prospectuses, proxies, etc.).

(2) Plan C is an individual account plan described in section 3(34) of the Act under which participants and beneficiaries may choose among three investment alternatives which otherwise meet the requirements of paragraph (b) of this section. The plan permits investment instruction with respect to each investment alternative only on the first 10 days of each calendar quarter, *i.e.*, January 1-10, April 1-10, July 1-10 and October 1-10. Plan C satisfies the condition of paragraph (b)(2)(ii)(C)(I) that instruction be permitted not less frequently than once within any three month period, since there is not any three month period during which control could not be exercised.

(3) Assume the same facts as in paragraph (f)(2), except that investment instruction may only be given on January 1, April 4, July 1 and October 1. Plan C is not an ERISA section 404(c) plan because it does not satisfy the condition of paragraph (b)(2)(ii)(C)(I) that instruction be permitted not less frequently than once within any three month period. Under these facts, there is a three month period, e.g., January 2 through April 1, during which control could not be exercised by participants and beneficiaries.

(4) Plan D is an individual account plan described in section 3(34) of the Act under which participants and beneficiaries may choose among three diversified investment alternatives which constitute a broad range of investment alternatives. The plan also permits investment instruction with respect

to an employer securities alternative but provides that a participant or beneficiary can invest no more than 25% of his account balance in this alternative. This restriction does not affect the availability of relief under section 404(c) inasmuch as it does not relate to the three diversified investment alternatives and, therefore, does not cause the plan to fail to provide an opportunity to choose from a broad range of investment alternatives.

(5) A participant, P, independently exercises control over assets in his individual account plan by directing a plan fiduciary, F, to invest 100% of his account balance in a single stock. P is not a fiduciary with respect to the plan by reason of his exercise of control and F will not be liable for any losses that necessarily result from P's investment instruction.

(6) Assume the same facts as in paragraph (f)(5), except that P directs F to purchase the stock from B, who is a party in interest with respect to the plan. Neither P nor F has engaged in a transaction prohibited under section 406 of the Act: P because he is not a fiduciary with respect to the plan by reason of his exercise of control and F because he is not liable for any breach of part 4 of title I that is the direct and necessary consequence of P's exercise of control. However, a prohibited transaction under section 4975(c) of the Internal Revenue Code may have occurred, and, in the absence of an exemption, tax liability may be imposed pursuant to sections 495 (a) and (b) of the Code.

(7) Assume the same facts as in paragraph (f)(5), except that P does not specify that the stock be purchased from B, and F chooses to purchase the stock from B. In the absence of an exemption, F has engaged in a prohibited transaction described in 406(a) of ERISA because the decision to purchase the stock from B is not a direct or necessary result of P's exercise of control.

(8) Pursuant to the terms of the plan, plan fiduciary F designates three reputable investment managers whom participants may appoint to manage assets in their individual accounts. Participant P selects M, one of the designated managers, to manage the assets in his account. M prudently manages P's account for 6 months after which he incurs losses in managing the account through his imprudence. M has engaged in a breach of fiduciary duty because M's imprudent management of P's account is not a direct or necessary result of P's exercise of control (the choice of M as manager). F has no fiduciary liability for M's imprudence because he has no affirmative duty to advise P (see paragraph (c)(4)) and because F is relieved of co-fiduciary liability by reason of section 404(c)(2) (see paragraph (d)(2)(iii)). F does have a duty to monitor M's performance to determine the suitability of continuing M as an investment manager, however, and M's

imprudence would be a factor which F must consider in periodically reevaluating its decision to designate M.

(9) Participant P instructs plan fiduciary F to appoint G as his investment manager pursuant to the terms of the plan which provide P total discretion in choosing an investment manager. Through G's imprudence, G incurs losses in managing P's account. G has engaged in a breach of fiduciary duty because G's imprudent management of P's account is not a direct or necessary result of P's exercise of control (the choice of G as manager). Plan fiduciary F has no fiduciary liability for G's imprudence because F has no obligation to advise P (see paragraph (c)(4)) and because F is relieved of co-fiduciary liability for G's actions by reason of section 404(c)(2) (see paragraph (d)(2)(iii)). In addition, F also has no duty to determine the suitability of G as an investment manager because the plan does not designate G as an investment manager.

(10) Participant P directs a plan fiduciary, F, a bank, to invest all of the assets in his individual account in a collective trust fund managed by F that is designed to be invested solely in a diversified portfolio of common stocks. Due to economic conditions, the value of the common stocks in the bank collective trust fund declines while the value of publicly-offered fixed income obligations remains relatively stable. F is not liable for any losses incurred by P solely because his individual account was not diversified to include fixed income obligations. Such losses are the direct result of P's exercise of control; moreover, under paragraph (c)(4) of this section F has no obligation to advise P regarding his investment decisions.

(11) Assume the same facts as in paragraph (f)(10) except that F, in managing the collective trust fund, invests the assets of the fund solely in a few highly speculative stocks. F is liable for losses resulting from its imprudent investment in the speculative stocks and for its failure to diversify the assets of the account. This conduct involves a separate breach of F's fiduciary duty that is not a direct or necessary result of P's exercise of control (see paragraph (d)(2)(iii)).

(g) *Effective date*—(1) *In general.* Except as provided in paragraph (g)(2), this section is effective with respect to transactions occurring on or after the first day of the second plan year beginning on or after October 13, 1992.

(2) This section is effective with respect to transactions occurring under a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers ratified before October 13, 1992 after the later of the

date determined under paragraph (g)(1) or the date on which the last collective bargaining agreement terminates. For purposes of this paragraph (g)(2), any extension or renegotiation of a collective bargaining agreement which is ratified on or after October 13, 1992 is to be disregarded in determining the date on which the agreement terminates.

(3) Transactions occurring before the date determined under subparagraph (g)(1) or (2) of this section, as applicable, are governed by section 404(c) of the Act without regard to the regulation.

[57 FR 46932, Oct. 13, 1992]

§ 2550.404c-5 Fiduciary relief for investments in qualified default investment alternatives.

(a) *In general.* (1) This section implements the fiduciary relief provided under section 404(c)(5) of the Employee Retirement Income Security Act of 1974, as amended (ERISA or the Act), 29 U.S.C. 1001 et seq., under which a participant or beneficiary in an individual account plan will be treated as exercising control over the assets in his or her account for purposes of ERISA section 404(c)(1) with respect to the amount of contributions and earnings that, in the absence of an investment election by the participant, are invested by the plan in accordance with this regulation. If a participant or beneficiary is treated as exercising control over the assets in his or her account in accordance with ERISA section 404(c)(1) no person who is otherwise a fiduciary shall be liable under part 4 of title I of ERISA for any loss or by reason of any breach which results from such participant's or beneficiary's exercise of control. Except as specifically provided in paragraph (c)(6) of this section, a plan need not meet the requirements for an ERISA section 404(c) plan under 29 CFR 2550.404c-1 in order for a plan fiduciary to obtain the relief under this section.

(2) The standards set forth in this section apply solely for purposes of determining whether a fiduciary meets the requirements of this regulation. Such standards are not intended to be

the exclusive means by which a fiduciary might satisfy his or her responsibilities under the Act with respect to the investment of assets in the individual account of a participant or beneficiary.

(b) *Fiduciary relief.* (1) Except as provided in paragraphs (b)(2), (3), and (4) of this section, a fiduciary of an individual account plan that permits participants or beneficiaries to direct the investment of assets in their accounts and that meets the conditions of paragraph (c) of this section shall not be liable for any loss, or by reason of any breach under part 4 of title I of ERISA, that is the direct and necessary result of (i) investing all or part of a participant's or beneficiary's account in any qualified default investment alternative within the meaning of paragraph (e) of this section, or (ii) investment decisions made by the entity described in paragraph (e)(3) of this section in connection with the management of a qualified default investment alternative.

(2) Nothing in this section shall relieve a fiduciary from his or her duties under part 4 of title I of ERISA to prudently select and monitor any qualified default investment alternative under the plan or from any liability that results from a failure to satisfy these duties, including liability for any resulting losses.

(3) Nothing in this section shall relieve any fiduciary described in paragraph (e)(3)(i) of this section from its fiduciary duties under part 4 of title I of ERISA or from any liability that results from a failure to satisfy these duties, including liability for any resulting losses.

(4) Nothing in this section shall provide relief from the prohibited transaction provisions of section 406 of ERISA, or from any liability that results from a violation of those provisions, including liability for any resulting losses.

(c) *Conditions.* With respect to the investment of assets in the individual account of a participant or beneficiary, a fiduciary shall qualify for the relief described in paragraph (b)(1) of this section if:

(1) Assets are invested in a qualified default investment alternative within

the meaning of paragraph (e) of this section;

(2) The participant or beneficiary on whose behalf the investment is made had the opportunity to direct the investment of the assets in his or her account but did not direct the investment of the assets;

(3) The participant or beneficiary on whose behalf an investment in a qualified default investment alternative may be made is furnished a notice that meets the requirements of paragraph (d) of this section:

(i) (A) At least 30 days in advance of the date of plan eligibility, or at least 30 days in advance of the date of any first investment in a qualified default investment alternative on behalf of a participant or beneficiary described in paragraph (c)(2) of this section; or

(B) On or before the date of plan eligibility provided the participant has the opportunity to make a permissible withdrawal (as determined under section 414(w) of the Internal Revenue Code of 1986, as amended (Code)); and

(ii) Within a reasonable period of time of at least 30 days in advance of each subsequent plan year;

(4) A fiduciary provides to a participant or beneficiary the material set forth in 29 CFR 2550.404c-1(b)(2)(i)(B)(1)(viii) and (ix) and 29 CFR 404c-1(b)(2)(i)(B)(2) relating to a participant's or beneficiary's investment in a qualified default investment alternative;

(5)(i) Any participant or beneficiary on whose behalf assets are invested in a qualified default investment alternative may transfer, in whole or in part, such assets to any other investment alternative available under the plan with a frequency consistent with that afforded to a participant or beneficiary who elected to invest in the qualified default investment alternative, but not less frequently than once within any three month period;

(ii)(A) Except as provided in paragraph (c)(5)(ii)(B) of this section, any transfer described in paragraph (c)(5)(i), or any permissible withdrawal as determined under section 414(w)(2) of the Code, by a participant or beneficiary of assets invested in a qualified default investment alternative, in whole or in part, resulting from the

participant's or beneficiary's election to make such a transfer or withdrawal during the 90-day period beginning on the date of the participant's first elective contribution as determined under section 414(w)(2)(B) of the Code, or other first investment in a qualified default investment alternative on behalf of a participant or beneficiary described in paragraph (c)(2) of this section, shall not be subject to any restrictions, fees or expenses (including surrender charges, liquidation or exchange fees, redemption fees and similar expenses charged in connection with the liquidation of, or transfer from, the investment);

(B) Paragraph (c)(5)(ii)(A) of this section shall not apply to fees and expenses that are charged on an ongoing basis for the operation of the investment itself (such as investment management fees, distribution and/or service fees, "12b-1" fees, or legal, accounting, transfer agent and similar administrative expenses), and are not imposed, or do not vary, based on a participant's or beneficiary's decision to withdraw, sell or transfer assets out of the qualified default investment alternative; and

(iii) Following the end of the 90-day period described in paragraph (c)(5)(ii)(A) of this section, any transfer or permissible withdrawal described in this paragraph (c)(5) of this section shall not be subject to any restrictions, fees or expenses not otherwise applicable to a participant or beneficiary who elected to invest in that qualified default investment alternative; and

(6) The plan offers a "broad range of investment alternatives" within the meaning of 29 CFR 2550.404c-1(b)(3).

(d) *Notice.* The notice required by paragraph (c)(3) of this section shall be written in a manner calculated to be understood by the average plan participant and shall contain the following:

(1) A description of the circumstances under which assets in the individual account of a participant or beneficiary may be invested on behalf of the participant or beneficiary in a qualified default investment alternative; and, if applicable, an explanation of the circumstances under which elective contributions will be made on behalf of a participant, the

percentage of such contributions, and the right of the participant to elect not to have such contributions made on the participant's behalf (or to elect to have such contributions made at a different percentage);

(2) An explanation of the right of participants and beneficiaries to direct the investment of assets in their individual accounts;

(3) A description of the qualified default investment alternative, including a description of the investment objectives, risk and return characteristics (if applicable), and fees and expenses attendant to the investment alternative;

(4) A description of the right of the participants and beneficiaries on whose behalf assets are invested in a qualified default investment alternative to direct the investment of those assets to any other investment alternative under the plan, including a description of any applicable restrictions, fees or expenses in connection with such transfer; and

(5) An explanation of where the participants and beneficiaries can obtain investment information concerning the other investment alternatives available under the plan.

(e) *Qualified default investment alternative.* For purposes of this section, a qualified default investment alternative means an investment alternative available to participants and beneficiaries that:

(1)(i) Does not hold or permit the acquisition of employer securities, except as provided in paragraph (ii).

(ii) Paragraph (e)(1)(i) of this section shall not apply to: (A) Employer securities held or acquired by an investment company registered under the Investment Company Act of 1940 or a similar pooled investment vehicle regulated and subject to periodic examination by a State or Federal agency and with respect to which investment in such securities is made in accordance with the stated investment objectives of the investment vehicle and independent of the plan sponsor or an affiliate thereof; or (B) with respect to a qualified default investment alternative described in paragraph (e)(4)(iii) of this section, employer securities acquired as a matching contribution from

the employer/plan sponsor, or employer securities acquired prior to management by the investment management service to the extent the investment management service has discretionary authority over the disposition of such employer securities;

(2) Satisfies the requirements of paragraph (c)(5) of this section regarding the ability of a participant or beneficiary to transfer, in whole or in part, his or her investment from the qualified default investment alternative to any other investment alternative available under the plan;

(3) Is:

(i) Managed by: (A) an investment manager, within the meaning of section 3(38) of the Act; (B) a trustee of the plan that meets the requirements of section 3(38)(A), (B) and (C) of the Act; or

(C) the plan sponsor, or a committee comprised primarily of employees of the plan sponsor, which is a named fiduciary within the meaning of section 402(a)(2) of the Act;

(ii) An investment company registered under the Investment Company Act of 1940; or

(iii) An investment product or fund described in paragraph (e)(4)(iv) or (v) of this section; and

(4) Constitutes one of the following:

(i) An investment fund product or model portfolio that applies generally accepted investment theories, is diversified so as to minimize the risk of large losses and that is designed to provide varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures based on the participant's age, target retirement date (such as normal retirement age under the plan) or life expectancy. Such products and portfolios change their asset allocations and associated risk levels over time with the objective of becoming more conservative (*i.e.*, decreasing risk of losses) with increasing age. For purposes of this paragraph (e)(4)(i), asset allocation decisions for such products and portfolios are not required to take into account risk tolerances, investments or other preferences of an individual participant. An example of such a fund or portfolio may be

a "life-cycle" or "targeted-retirement-date" fund or account.

(ii) An investment fund product or model portfolio that applies generally accepted investment theories, is diversified so as to minimize the risk of large losses and that is designed to provide long-term appreciation and capital preservation through a mix of equity and fixed income exposures consistent with a target level of risk appropriate for participants of the plan as a whole. For purposes of this paragraph (e)(4)(ii), asset allocation decisions for such products and portfolios are not required to take into account the age, risk tolerances, investments or other preferences of an individual participant. An example of such a fund or portfolio may be a "balanced" fund.

(iii) An investment management service with respect to which a fiduciary, within the meaning of paragraph (e)(3)(i) of this section, applying generally accepted investment theories, allocates the assets of a participant's individual account to achieve varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures, offered through investment alternatives available under the plan, based on the participant's age, target retirement date (such as normal retirement age under the plan) or life expectancy. Such portfolios are diversified so as to minimize the risk of large losses and change their asset allocations and associated risk levels for an individual account over time with the objective of becoming more conservative (*i.e.*, decreasing risk of losses) with increasing age. For purposes of this paragraph (e)(4)(iii), asset allocation decisions are not required to take into account risk tolerances, investments or other preferences of an individual participant. An example of such a service may be a "managed account."

(iv)(A) Subject to paragraph (e)(4)(iv)(B) of this section, an investment product or fund designed to preserve principal and provide a reasonable rate of return, whether or not such return is guaranteed, consistent with liquidity. Such investment product shall for purposes of this paragraph (e)(4)(iv):

(1) Seek to maintain, over the term of the investment, the dollar value that is equal to the amount invested in the product; and

(2) Be offered by a State or federally regulated financial institution.

(B) An investment product described in this paragraph (e)(4)(iv) shall constitute a qualified default investment alternative for purposes of paragraph (e) of this section for not more than 120 days after the date of the participant's first elective contribution (as determined under section 414(w)(2)(B) of the Code).

(v)(A) Subject to paragraph (e)(4)(v)(B) of this section, an investment product or fund designed to preserve principal; provide a rate of return generally consistent with that earned on intermediate investment grade bonds; and provide liquidity for withdrawals by participants and beneficiaries, including transfers to other investment alternatives. Such investment product or fund shall, for purposes of this paragraph (e)(4)(v), meet the following requirements:

(1) There are no fees or surrender charges imposed in connection with withdrawals initiated by a participant or beneficiary; and

(2) Such investment product or fund invests primarily in investment products that are backed by State or federally regulated financial institutions.

(B) An investment product or fund described in this paragraph (e)(4)(v) shall constitute a qualified default investment alternative for purposes of paragraph (e) of this section solely for purposes of assets invested in such product or fund before December 24, 2007.

(vi) An investment fund product or model portfolio that otherwise meets the requirements of this section shall not fail to constitute a product or portfolio for purposes of paragraph (e)(4)(i) or (ii) of this section solely because the product or portfolio is offered through variable annuity or similar contracts or through common or collective trust funds or pooled investment funds and without regard to whether such contracts or funds provide annuity purchase rights, investment guarantees, death benefit guarantees or other fea-

tures ancillary to the investment fund product or model portfolio.

(f) *Preemption of State laws.* (1) Section 514(e)(1) of the Act provides that title I of the Act supersedes any State law that would directly or indirectly prohibit or restrict the inclusion in any plan of an automatic contribution arrangement. For purposes of section 514(e) of the Act and this paragraph (f), an automatic contribution arrangement is an arrangement (or the provisions of a plan) under which:

(i) A participant may elect to have the plan sponsor make payments as contributions under the plan on his or her behalf or receive such payments directly in cash;

(ii) A participant is treated as having elected to have the plan sponsor make such contributions in an amount equal to a uniform percentage of compensation provided under the plan until the participant specifically elects not to have such contributions made (or specifically elects to have such contributions made at a different percentage); and

(iii) Contributions are invested in accordance with paragraphs (a) through (e) of this section.

(2) A State law that would directly or indirectly prohibit or restrict the inclusion in any pension plan of an automatic contribution arrangement is superseded as to any pension plan, regardless of whether such plan includes an automatic contribution arrangement as defined in paragraph (f)(1) of this section.

(3) The administrator of an automatic contribution arrangement within the meaning of paragraph (f)(1) of this section shall be considered to have satisfied the notice requirements of section 514(e)(3) of the Act if notices are furnished in accordance with paragraphs (c)(3) and (d) of this section.

(4) Nothing in this paragraph (f) precludes a pension plan from including an automatic contribution arrangement that does not meet the conditions of paragraphs (a) through (e) of this section.

[72 FR 60478, Oct. 24, 2007; 73 FR 23350, Apr. 30, 2008]

§ 2550.407a-1 General rule for the acquisition and holding of employer securities and employer real property.

(a) *In general.* Section 407(a)(1) of the Employee Retirement Income Security Act of 1974 (the Act) states that except as otherwise provided in section 407 and section 414 of the Act, a plan may not acquire or hold any employer security which is not a qualifying employer security or any employer real property which is not qualifying employer real property. Section 406(a)(1)(E) prohibits a fiduciary from knowingly causing a plan to engage in a transaction which constitutes a direct or indirect acquisition, on behalf of a plan, of any employer security or employer real property in violation of section 407(a), and section 406(a)(2) prohibits a fiduciary who has authority or discretion to control or manage assets of a plan to permit the plan to hold any employer security or employer real property if he knows or should know that holding such security or real property violates section 407(a).

(b) *Requirements applicable to all plans.* A plan may hold or acquire only employer securities which are qualifying employer securities and employer real property which is qualifying employer real property. A plan may not hold employer securities and employer real property which are not qualifying employer securities and qualifying employer real property, except to the extent that:

(1) The employer security is held by a plan which has made an election under section 407(c)(3) of the Act; or

(2) The employer security is a loan or other extension of credit which satisfies the requirements of section 414(c)(1) of the Act or the employer real property is leased to the employer pursuant to a lease which satisfies the requirements of section 414(c)(2) of the Act.

[42 FR 47201, Sept. 20, 1977; 42 FR 59842, Nov. 22, 1977]

§ 2550.407a-2 Limitation with respect to the acquisition of qualifying employer securities and qualifying employer real property.

(a) *In general.* Section 407(a)(2) of the Employee Retirement Income Security

Act of 1974 (the Act) provides that a plan may not acquire any qualifying employer security or qualifying employer real property, if immediately after such acquisition the aggregate fair market value of qualifying employer securities and qualifying employer real property held by the plan exceeds 10 percent of the fair market value of the assets of the plan.

(b) *Acquisition.* For purposes of section 407(a) of the Act, an acquisition by a plan of qualifying employer securities or qualifying employer real property shall include, but not be limited to, an acquisition by purchase, by the exchange of plan assets, by the exercise of warrants or rights, by the conversion of a security (except any acquisition pursuant to a conversion exempt under section 408(b)(7) of the Act), by default of a loan where the qualifying employer security or qualifying employer real property was security for the loan, or by the contribution of such securities or real property to the plan. However, an acquisition of a security shall not be deemed to have occurred if a plan acquires the security as a result of a stock dividend or stock split.

(c) *Fair market value—Indebtedness incurred in connection with the acquisition of a plan asset.* In determining whether a plan is in compliance with the limitation on the acquisition of qualifying employer securities and qualifying employer real property in section 407(a)(2), the limitation on the holding of qualifying employer securities and qualifying employer real property in section 407(a)(3) and § 2550.407a-3 thereunder, and the requirement regarding the disposition of employer securities and employer real property in section 407(a)(4) and § 2550.407a-4 thereunder, the fair market value of total plan assets shall be the fair market value of such assets less the unpaid amount of:

(1) Any indebtedness incurred by the plan in acquiring such assets;

(2) Any indebtedness incurred before the acquisition of such assets if such indebtedness would not have been incurred but for such acquisition; and

(3) Any indebtedness incurred after the acquisition of such assets if such indebtedness would not have been incurred but for such acquisition and the incurrence of such indebtedness was

reasonably foreseeable at the time of such acquisition. However, the fair market value of qualifying employer securities and qualifying employer real property shall be the fair market value of such assets without any reduction for the unpaid amount of any indebtedness incurred by the plan in connection with the acquisition of such employer securities and employer real property.

(d) *Examples.* (1) Plan assets have a fair market value of \$100,000. The plan has no liabilities other than liabilities for vested benefits of participants and does not own any employer securities or employer real property. The plan proposes to acquire qualifying employer securities with a fair market value of \$10,000 by paying \$1,000 in cash and borrowing \$9,000. The fair market value of plan assets would be \$100,000 (\$100,000 of plan assets less \$1,000 cash payment plus \$10,000 of employer securities less \$9,000 indebtedness), the fair market value of the qualifying employer securities would be \$10,000, which is 10 percent of the fair market value of plan assets. Accordingly, the acquisition would not contravene section 407(a).

(2) Plan assets have a fair market value of \$100,000. The plan has liabilities of \$20,000 which were incurred in connection with the acquisition of those assets, and does not own any employer securities or employer real property. The plan proposes to pay cash for qualifying employer securities with a fair market value of \$10,000. The fair market value of plan assets would be \$80,000 (\$100,000 of plan assets less \$10,000 cash payment plus \$10,000 of employer securities less \$20,000 indebtedness), the fair market value of the qualifying employer securities would be \$10,000, which is 12.5 percent of the fair market value of plan assets. Accordingly, the acquisition would contravene section 407(a).

[42 FR 47201, Sept. 20, 1977]

§ 2550.407d-5 Definition of the term “qualifying employer security”.

(a) *In general.* For purposes of this section and section 407(d)(5) of the Employee Retirement Income Security Act of 1974 (the Act), the term “qualifying employer security” means an employer security which is:

(1) Stock; or

(2) A marketable obligation, as defined in paragraph (b) of this section and section 407(e) of the Act.

(b) For purposes of paragraph (a)(2) of this section and section 407(d)(5) of the Act, the term “marketable obligation” means a bond, debenture, note, or certificate, or other evidence of indebtedness (hereinafter in this paragraph referred to as “obligation”) if:

(1) Such obligation is acquired—

(i) On the market, either—

(A) At the price of the obligation prevailing on a national securities exchange which is registered with the Securities and Exchange Commission, or

(B) If the obligation is not traded on such a national securities exchange, at a price not less favorable to the plan than the offering price for the obligation as established by current bid and asked prices quoted by persons independent of the issuer;

(ii) From an underwriter, at a price—

(A) Not in excess of the public offering price for the obligation as set forth in a prospectus or offering circular filed with the Securities and Exchange Commission, and

(B) At which a substantial portion of the same issue is acquired by persons independent of the issuer; or

(iii) Directly from the issuer at a price not less favorable to the plan than the price paid currently for a substantial portion of the same issue by persons independent of the issuer;

(2) Immediately following acquisition of such obligation,

(i) Not more than 25 percent of the aggregate amount of obligations issued in such issue and outstanding at the time of acquisition is held by the plan, and

(ii) At least 50 percent of the aggregate amount referred to in paragraph (A) is held by persons independent of the issuer; and

(3) Immediately following acquisition of the obligation, not more than 25 percent of the assets of the plan is invested in obligations of the employer or an affiliate of the employer.

[42 FR 44388, Sept. 2, 1977]

§ 2550.407d-6 Definition of the term “employee stock ownership plan”.

(a) *In general*—(1) *Type of plan.* To be an “ESOP” (employee stock ownership plan), a plan described in section 407(d)(6)(A) of the Employee Retirement Income Security Act of 1974 (the Act) must meet the requirements of this section. See section 407(d)(6)(B).

(2) *Designation as ESOP.* To be an ESOP, a plan must be formally designated as such in the plan document.

(3) *Retroactive amendment.* A plan meets the requirements of this section as of the date that it is designated as an ESOP if it is amended retroactively to meet, and in fact does meet, such requirements at any of the following times:

(i) 12 months after the date on which the plan is designated as an ESOP;

(ii) 90 days after a determination letter is issued with respect to the qualification of the plan as an ESOP under this section, but only if the determination is requested by the date in paragraph (a)(3)(i) of this section; or

(iii) A later date approved by the Internal Revenue Service district director.

(4) *Addition to other plan.* An ESOP may form a portion of a plan the balance of which includes a qualified pension, profit-sharing, or stock bonus plan which is not an ESOP. A reference to an ESOP includes an ESOP that forms a portion of another plan.

(5) *Conversion of existing plan to an ESOP.* If an existing pension, profit-sharing, or stock bonus plan is converted into an ESOP, the requirements of section 404 of the Act, relating to fiduciary duties, and section 401(a) of the Internal Revenue Code (the Code), relating to requirements for plans established for the exclusive benefit of employees, apply to such conversion. A conversion may constitute a termination of an existing plan. For definition of a termination, see the regulations under section 411(d)(3) of the Code and section 4041(f) of the Act.

(6) *Certain arrangements barred*—(i) *Buy-sell agreements.* An arrangement involving an ESOP that creates a put option must not provide for the issuance of put options other than as provided under § 2550.408b-3 (j), (k) and (l). Also, an ESOP must not otherwise obligate

itself to acquire securities from a particular security holder at an indefinite time determined upon the happening of an event such as the death of the holder.

(b) *Plan designed to invest primarily in qualifying employer securities.* A plan constitutes an ESOP only if the plan specifically states that it is designed to invest primarily in qualifying employer securities. Thus, a stock bonus plan or a money purchase pension plan constituting an ESOP may invest part of its assets in other than qualifying employer securities. Such plan will be treated the same as other stock bonus plans or money purchase pension plans qualified under section 401(a) of the Code with respect to those investments.

(c) *Regulations of the Secretary of the Treasury.* A plan constitutes an ESOP for a plan year only if it meets such other requirements as the Secretary of the Treasury may prescribe by regulation under section 4975(e)(7) of the Code. (See 26 CFR 54.4975-11).

[42 FR 44388, Sept. 2, 1977]

§ 2550.408b-1 General statutory exemption for loans to plan participants and beneficiaries who are parties in interest with respect to the plan.

(a)(1) *In general.* Section 408(b)(1) of the Employee Retirement Income Security Act of 1974 (the Act or ERISA) exempts from the prohibitions of section 406(a), 406(b)(1) and 406(b)(2) loans by a plan to parties in interest who are participants or beneficiaries of the plan, provided that such loans:

(i) Are available to all such participants and beneficiaries on a reasonably equivalent basis;

(ii) Are not made available to highly compensated employees, officers or shareholders in an amount greater than the amount made available to other employees;

(iii) Are made in accordance with specific provisions regarding such loans set forth in the plan;

(iv) Bear a reasonable rate of interest; and

(v) Are adequately secured.

The Internal Revenue Code (the Code) contains parallel provisions to section

408(b)(1) of the Act. Effective, December 31, 1978, section 102 of Reorganization Plan No. 4 of 1978 (43 FR 47713, October 17, 1978) transferred the authority of the Secretary of the Treasury to promulgate regulations of the type published herein to the Secretary of Labor. Therefore, all references herein to section 408(b)(1) of the Act should be read to include reference to the parallel provisions of section 4975(d)(1) of the Code.

Section 1114(b)(15)(B) of the Tax Reform Act of 1986 amended section 408(b)(1)(B) of ERISA by deleting the phrase "highly compensated employees, officers or shareholders" and substituting the phrase "highly compensated employees (within the meaning of section 414(q) of the Internal Revenue Code of 1986)." Thus, for plans with participant loan programs which are subject to the amended section 408(b)(1)(B), the requirements of this regulation should be read to conform with the amendment.

(2) *Scope.* Section 408(b)(1) of the Act does not contain an exemption from acts described in section 406(b)(3) of the Act (prohibiting fiduciaries from receiving consideration for their own personal account from any party dealing with a plan in connection with a transaction involving plan assets). If a loan from a plan to a participant who is a party in interest with respect to that plan involves an act described in section 406(b)(3), such an act constitutes a separate transaction which is not exempt under section 408(b)(1) of the Act. The provisions of section 408(b)(1) are further limited by section 408(d) of the Act (relating to transactions with owner-employees and related persons).

(3) *Loans.* (i) Section 408(b)(1) of the Act provides relief from the prohibitions of section 406(a), 406(b)(1) and 406(b)(2) for the making of a participant loan. The term "participant loan" refers to a loan which is arranged and approved by the fiduciary administering the loan program primarily in the interest of the participant and which otherwise satisfies the criteria set forth in section 408(b)(1) of the Act. The existence of a participant loan or participant loan program will be determined upon consideration of all relevant facts and circumstances. Thus,

for example, the mere presence of a loan document appearing to satisfy the requirements of section 408(b)(1) will not be dispositive of whether a participant loan exists where the subsequent administration of the loan indicates that the parties to the loan agreement did not intend the loan to be repaid. Moreover, a loan program containing a precondition designed to benefit a party in interest (other than the participant) is not afforded relief by section 408(b)(1) or this regulation. In this regard, section 408(b)(1) recognizes that a program of participant loans, like other plan investments, must be prudently established and administered for the exclusive purpose of providing benefits to participants and beneficiaries of the plan.

(ii) For the purpose of this regulation, the term "loan" will include any renewal or modification of an existing loan agreement, provided that, at the time of each such renewal or modification, the requirements of section 408(b)(1) and this regulation are met.

(4) *Examples.* The following examples illustrate the provisions of § 2550.408b-1(a).

Example 1: T, a trustee of plan P, has exclusive discretion over the management and disposition of plan assets. As a result, T is a fiduciary with respect to P under section 3(21)(A) of the Act and a party in interest with respect to P pursuant to section 3(14)(A) of the Act. T is also a participant in P. Among T's duties as fiduciary is the administration of a participant loan program which meets the requirements of section 408(b)(1) of the Act. Pursuant to strict objective criteria stated under the program, T, who participates in all loan decisions, receives a loan on the same terms as other participants. Although the exercise of T's discretion on behalf of himself may constitute an act of self-dealing described in section 406(b)(1), section 408(b)(1) provides an exemption from section 406(b)(1). As a result, the loan from P to T would be exempt under section 408(b)(1), provided the conditions of that section are otherwise satisfied.

Example 2: P is a plan covering all the employees of E, the employer who established and maintained P. F is a fiduciary with respect to P and an officer of E. The plan documents governing P give F the authority to establish a participant loan program in accordance with section 408(b)(1) of the Act. Pursuant to an arrangement with E, F establishes such a program but limits the use of

loan funds to investments in a limited partnership which is established and maintained by E as general partner. Under these facts, the loan program and any loans made pursuant to this program are outside the scope of relief provided by section 408(b)(1) because the loan program is designed to operate for the benefit of E. Under the circumstances described, the diversion of plan assets for E's benefit would also violate sections 403(c)(1) and 404(a) of the Act.

Example 3: Assume the same facts as in Example 2, above, except that F does not limit the use of loan funds. However, E pressures his employees to borrow funds under P's participant loan program and then reloan the loan proceeds to E. F, unaware of E's activities, arranges and approves the loans. If the loans meet all the conditions of section 408(b)(1), such loans will be exempt under that section. However, E's activities would cause the entire transaction to be viewed as an indirect transfer of plan assets between P and E, who is a party in interest with respect to P, but not the participant borrowing from P. By coercing the employees to engage in loan transactions for its benefit, E has engaged in separate transactions that are not exempt under section 408(b)(1). Accordingly, E would be liable for the payment of excise taxes under section 4975 of the Code.

Example 4: Assume the same facts as in Example 2, above, except that, in return for structuring and administering the loan program as indicated, E agrees to pay F an amount equal to 10 percent of the funds loaned under the program. Such a payment would result in a separate transaction not covered by section 408(b)(1). This transaction would be prohibited under section 406(b)(3) since F would be receiving consideration from a party in connection with a transaction involving plan assets.

Example 5: F is a fiduciary with respect to plan P. D is a party in interest with respect to plan P. Section 406(a)(1)(B) of the Act would prohibit F from causing P to lend money to D. However, F enters into an agreement with Z, a plan participant, whereby F will cause P to make a participant loan to Z with the express understanding that Z will subsequently lend the loan proceeds to D. An examination of Z's credit standing indicates that he is not creditworthy and would not, under normal circumstances, receive a loan under the conditions established by the participant loan program. F's decision to approve the participant loan to Z on the basis of Z's prior agreement to lend the money to D violates the exclusive purpose requirements of sections 403(c) and 404(a). In effect, the entire transaction is viewed as an indirect transfer of plan assets between P and D, and not a loan to a participant exempt under section 408(b)(1). Z's lack of credit standing would also cause the transaction to fail under section 408(b)(1)(A) of the Act.

Example 6: F is a fiduciary with respect to Plan P. Z is a plan participant. Z and D are both parties in interest with respect to P. F approves a participant loan to Z in accordance with the conditions established under the participant loan program. Upon receipt of the loan, Z intends to lend the money to D. If F has approved this loan solely upon consideration of those factors which would be considered in a normal commercial setting by an entity in the business of making comparable loans, Z's subsequent use of the loan proceeds will not affect the determination of whether loans under P's program satisfy the conditions of section 408(b)(1).

Example 7: A is the trustee of a small individual account plan. D, the president of the plan sponsor, is also a participant in the plan. Pursuant to a participant loan program meeting the requirements of section 408(b)(1), D applies for a loan to be secured by a parcel of real property. D does not intend to repay the loan; rather, upon eventual default, he will permit the property to be foreclosed upon and transferred to the plan in discharge of his legal obligation to repay the loan. A, aware of D's intention, approves the loan. D fails to make two consecutive quarterly payments of principal and interest under the note evidencing the loan thereby placing the loan in default. The plan then acquires the real property upon foreclosure. Such facts and circumstances indicate that the payment of money from the plan to D was not a participant loan eligible for the relief afforded by section 408(b)(1). In effect, this transaction is a prohibited sale or exchange of property between a plan and a party in interest from the time D receives the money.

Example 8: Plan P establishes a participant loan program. All loans are subject to the condition that the borrowed funds must be used to finance home purchases. Interest rates on the loans are the same as those charged by a local savings and loan association under similar circumstances. A loan by P to a participant to finance a home purchase would be subject to the relief provided by section 408(b)(1) provided that the conditions of 408(b)(1) are met. A participant loan program which is established to make loans for certain stated purposes (e.g., hardship, college tuition, home purchases, etc.) but which is not otherwise designed to benefit parties in interest (other than plan participants) would not, in itself, cause such program to be ineligible for the relief provided by section 408(b)(1). However, fiduciaries are cautioned that operation of a loan program with limitations may result in loans not being made available to all participants and beneficiaries on a reasonably equivalent basis.

(b) *Reasonably equivalent basis.* (1) Loans will not be considered to have

been made available to participants and beneficiaries on a reasonably equivalent basis unless:

(i) Such loans are available to all plan participants and beneficiaries without regard to any individual's race, color, religion, sex, age or national origin;

(ii) In making such loans, consideration has been given only to those factors which would be considered in a normal commercial setting by an entity in the business of making similar types of loans. Such factors may include the applicant's creditworthiness and financial need; and

(iii) An evaluation of all relevant facts and circumstances indicates that, in actual practice, loans are not unreasonably withheld from any applicant.

(2) A participant loan program will not fail the requirement of paragraph (b)(1) of this section or § 2550.408b-1(c) if the program establishes a minimum loan amount of up to \$1,000, provided that the loans granted meet the requirements of § 2550.408b-1(f).

(3) *Examples.* The following examples illustrate the provisions of § 2550.408b-1(b)(1):

Example 1: T, a trustee of plan P, has exclusive discretion over the management and disposition of plan assets. T's duties include the administration of a participant loan program which meets the requirements of section 408(b)(1) of the Act. T receives a participant loan at a lower interest rate than the rate made available to other plan participants of similar financial condition or creditworthiness with similar security. The loan by P to T would not be covered by the relief provided by section 408(b)(1) because loans under P's program are not available to all plan participants on a reasonably equivalent basis.

Example 2: Same facts as in example 1, except that T is a member of a committee of trustees responsible for approving participant loans. T pressures the committee to refuse loans to other qualified participants in order to assure that the assets allocated to the participant loan program would be available for a loan by P to T. The loan by P to T would not be covered by the relief provided by section 408(b)(1) since participant loans have not been made available to all participants and beneficiaries on a reasonably equivalent basis.

Example 3: T is the trustee of plan P, which covers the employees of E. A, B and C are employees of E, participants in P, and friends of T. The documents governing P provide that T, in his discretion, may establish

a participant loan program meeting certain specified criteria. T institutes such a program and tells A, B and C of his decision. Before T is able to notify P's other participants and beneficiaries of the loan program, A, B, and C file loan applications which, if approved, will use up substantially all of the funds set aside for the loan program. Approval of these applications by T would represent facts and circumstances showing that loans under P's program are not available to all participants and beneficiaries on a reasonably equivalent basis.

(c) *Highly compensated employees.* (1) Loans will not be considered to be made available to highly compensated employees, officers or shareholders in an amount greater than the amount made available to other employees if, upon consideration of all relevant facts and circumstances, the program does not operate to exclude large numbers of plan participants from receiving loans under the program.

(2) A participant loan program will not fail to meet the requirement in paragraph (c)(1), of this section, merely because the plan documents specifically governing such loans set forth either (i) a maximum dollar limitation, or (ii) a maximum percentage of vested accrued benefit which no loan may exceed.

(3) If the second alternative in paragraph (c)(2) of this section (maximum percentage of vested accrued benefit) is chosen, a loan program will not fail to meet this requirement solely because maximum loan amounts will vary directly with the size of the participant's accrued benefit.

(4) *Examples.* The following examples illustrate the provisions of § 2550.408b-1(c).

Example 1: The documents governing plan P provide for the establishment of a participant loan program in which the amount of any loan under the program (when added to the outstanding balances of any other loans under the program to the same participant) does not exceed the lesser of (i) \$50,000, or (ii) one-half of the present value of that participant's vested accrued benefit under the plan (but not less than \$10,000). P's participant loan program does not fail to meet the requirement in section 408(b)(1)(B) of the Act, and would be covered by the relief provided by section 408(b)(1) if the other conditions of that section are met.

Example 2: The documents governing plan T provide for the establishment of a participant loan program in which the minimum

loan amount would be \$25,000. The documents also require that the only security acceptable under the program would be the participant's vested accrued benefit. A, the plan fiduciary administering the loan program, finds that because of the restrictions in the plan documents only 20 percent of the plan participants, all of whom earn in excess of \$75,000 a year, would meet the threshold qualifications for a loan. Most of these participants are high-level supervisors or corporate officers. Based on these facts, it appears that loans under the program would be made available to highly compensated employees in an amount greater than the amount made available to other employees. As a result, the loan program would fail to meet the requirement in section 408(b)(1)(B) of the Act and would not be covered by the relief provided in section 408(b)(1).

(d) *Specific plan provisions.* For the purpose of section 408(b)(1) and this regulation, the Department will consider that participant loans granted or renewed at any time prior to the last day of the first plan year beginning on or after January 1, 1989, are made in accordance with specific provisions regarding such loans set forth in the plan if:

(1) The plan provisions regarding such loans contain (at a minimum) an explicit authorization for the plan fiduciary responsible for investing plan assets to establish a participant loan program; and

(2) For participant loans granted or renewed on or after the last day of the first plan year beginning on or after January 1, 1989, the participant loan program which is contained in the plan or in a written document forming part of the plan includes, but need not be limited to, the following:

(i) The identity of the person or positions authorized to administer the participant loan program;

(ii) A procedure for applying for loans;

(iii) The basis on which loans will be approved or denied;

(iv) Limitations (if any) on the types and amount of loans offered;

(v) The procedure under the program for determining a reasonable rate of interest;

(vi) The types of collateral which may secure a participant loan; and

(vii) The events constituting default and the steps that will be taken to pre-

serve plan assets in the event of such default.

Example 1: Plan P authorizes the trustee to establish a participant loan program in accordance with section 408(b)(1) of the Act. Pursuant to this explicit authority, the trustee establishes a written program which contains all of the information required by § 2550.408b-1(d)(2). Loans made pursuant to this authorization and the written loan program will not fail under section 408(b)(1)(C) of the Act merely because the specific provisions regarding such loans are contained in a separate document forming part of the plan. The specific provisions describing the loan program, whether contained in the plan or in a written document forming part of a plan, do affect the rights and obligations of the participants and beneficiaries under the plan and, therefore, must in accordance with section 102(a)(1) of the Act, be disclosed in the plan's summary plan description.

(e) *Reasonable rate of interest.* A loan will be considered to bear a reasonable rate of interest if such loan provides the plan with a return commensurate with the interest rates charged by persons in the business of lending money for loans which would be made under similar circumstances.

Example 1: Plan P makes a participant loan to A at the fixed interest rate of 8% for 5 years. The trustees, prior to making the loan, contacted two local banks to determine under what terms the banks would make a similar loan taking into account A's credit-worthiness and the collateral offered. One bank would charge a variable rate of 10% adjusted monthly for a similar loan. The other bank would charge a fixed rate of 12% under similar circumstances. Under these facts, the loan to A would not bear a reasonable rate of interest because the loan did not provide P with a return commensurate with interest rates charged by persons in the business of lending money for loans which would be made under similar circumstances. As a result, the loan would fail to meet the requirements of section 408(b)(1)(D) and would not be covered by the relief provided by section 408(b)(1) of the Act.

Example 2: Pursuant to the provisions of plan P's participant loan program, T, the trustee of P, approves a loan to M, a participant and party in interest with respect to P. At the time of execution, the loan meets all of the requirements of section 408(b)(1) of the Act. The loan agreement provides that at the end of two years M must pay the remaining balance in full or the parties may renew for an additional two year period. At the end of the initial two year period, the parties agree to renew the loan for an additional two years. At the time of renewal, however, A

fails to adjust the interest rate charged on the loan in order to reflect current economic conditions. As a result, the interest rate on the renewal fails to provide a "reasonable rate of interest" as required by section 408(b)(1)(D) of the Act. Under such circumstances, the loan would not be exempt under section 408(b)(1) of the Act from the time of renewal.

Example 3: The documents governing plan P's participant loan program provide that loans must bear an interest rate no higher than the maximum interest rate permitted under State X's usury law. Pursuant to the loan program, P makes a participant loan to A, a plan participant, at a time when the interest rates charged by financial institutions in the community (not subject to the usury limit) for similar loans are higher than the usury limit. Under these circumstances, the loan would not bear a reasonable rate of interest because the loan does not provide P with a return commensurate with the interest rates charged by persons in the business of lending money under similar circumstances. In addition, participant loans that are artificially limited to the maximum usury ceiling then prevailing call into question the status of such loans under sections 403(c) and 404(a) where higher yielding comparable investment opportunities are available to the plan.

(f) *Adequate security.* (1) A loan will be considered to be adequately secured if the security posted for such loan is something in addition to and supporting a promise to pay, which is so pledged to the plan that it may be sold, foreclosed upon, or otherwise disposed of upon default of repayment of the loan, the value and liquidity of which security is such that it may reasonably be anticipated that loss of principal or interest will not result from the loan. The adequacy of such security will be determined in light of the type and amount of security which would be required in the case of an otherwise identical transaction in a normal commercial setting between unrelated parties on arm's-length terms. A participant's vested accrued benefit under a plan may be used as security for a participant loan to the extent of the plan's ability to satisfy the participant's outstanding obligation in the event of default.

(2) For purposes of this paragraph,

(i) No more than 50% of the present value of a participant's vested accrued benefit may be considered by a plan as

security for the outstanding balance of all plan loans made to that participant;

(ii) A plan will be in compliance with paragraph (f)(2)(i) of this section if, with respect to any participant, it meets the provisions of paragraph (f)(2)(i) of this section immediately after the origination of each participant loan secured in whole or in part by that participant's vested accrued benefit; and

(iii) Any loan secured in whole or in part by a portion of a participant's vested accrued benefit must also meet the requirements of paragraph (f)(1) of this section.

(g) *Effective date.* This section is effective for all participant loans granted or renewed after October 18, 1989, except with respect to paragraph (d)(2) of this section relating to specific plan provisions. Paragraph (d)(2) of this section is effective for participant loans granted or renewed on or after the last day of the first plan year beginning on or after January 1, 1989.

(Approved by the Office of Management and Budget under control number 1210-0076)

[54 FR 30523, July 20, 1989]

§ 2550.408b-2 General statutory exemption for services or office space.

(a) *In general.* Section 408(b)(2) of the Employee Retirement Income Security Act of 1974 (the Act) exempts from the prohibitions of section 406(a) of the Act payment by a plan to a party in interest, including a fiduciary, for office space or any service (or a combination of services) if:

(1) Such office space or service is necessary for the establishment or operation of the plan;

(2) Such office space or service is furnished under a contract or arrangement which is reasonable; and

(3) No more than reasonable compensation is paid for such office space or service.

However, section 408(b)(2) does not contain an exemption from acts described in section 406(b)(1) of the Act (relating to fiduciaries dealing with the assets of plans in their own interest or for their own account), section 406(b)(2) of the Act (relating to fiduciaries in their individual or in any other capacity acting in any transaction involving the

plan on behalf of a party (or representing a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries) or section 406(b)(3) of the Act (relating to fiduciaries receiving consideration for their own personal account from any party dealing with a plan in connection with a transaction involving the assets of the plan). Such acts are separate transactions not described in section 408(b)(2). See § 2550.408b-2 (e) and (f) for guidance as to whether transactions relating to the furnishing of office space or services by fiduciaries to plans involve acts described in section 406(b)(1) of the Act. Section 408(b)(2) of the Act does not contain an exemption from other provisions of the Act, such as section 404, or other provisions of law which may impose requirements or restrictions relating to the transactions which are exempt under section 408(b)(2). See, for example, section 401 of the Internal Revenue Code of 1954. The provisions of section 408(b)(2) of the Act are further limited by section 408(d) of the Act (relating to transactions with owner-employees and related persons).

(b) *Necessary service.* A service is necessary for the establishment or operation of a plan within the meaning of section 408(b)(2) of the Act and § 2550.408b-2(a)(1) if the service is appropriate and helpful to the plan obtaining the service in carrying out the purposes for which the plan is established or maintained. A person providing such a service to a plan (or a person who is a party in interest solely by reason of a relationship to such a service provider described in section 3(14)(F), (G), (H), or (I) of the Act) may furnish goods which are necessary for the establishment or operation of the plan in the course of, and incidental to, the furnishing of such service to the plan.

(c) *Reasonable contract or arrangement.* No contract or arrangement is reasonable within the meaning of section 408(b)(2) of the Act and § 2550.408b-2(a)(2) if it does not permit termination by the plan without penalty to the plan on reasonably short notice under the circumstances to prevent the plan from becoming locked into an arrangement that has become disadvantageous. A long-term lease which may be termi-

nated prior to its expiration (without penalty to the plan) on reasonably short notice under the circumstances is not generally an unreasonable arrangement merely because of its long term. A provision in a contract or other arrangement which reasonably compensates the service provider or lessor for loss upon early termination of the contract, arrangement or lease is not a penalty. For example, a minimal fee in a service contract which is charged to allow recoument of reasonable start-up costs is not a penalty. Similarly, a provision in a lease for a termination fee that covers reasonably foreseeable expenses related to the vacancy and re-letting of the office space upon early termination of the lease is not a penalty. Such a provision does not reasonably compensate for loss if it provides for payment in excess of actual loss or if it fails to require mitigation of damages.

(d) *Reasonable compensation.* Section 408(b)(2) of the Act and § 2550.408b-2(a)(3) permit a plan to pay a party in interest reasonable compensation for the provision of office space or services described in section 408(b)(2) of the Act. Section 2550.408c-2 of these regulations contains provisions relating to what constitutes reasonable compensation for the provision of services.

(e) *Transactions with fiduciaries—(1) In general.* If the furnishing of office space or a service involves an act described in section 406(b) of the Act (relating to acts involving conflicts of interest by fiduciaries), such an act constitutes a separate transaction which is not exempt under section 408(b)(2) of the Act. The prohibitions of section 406(b) supplement the other prohibitions of section 406(a) of the Act by imposing on parties in interest who are fiduciaries a duty of undivided loyalty to the plans for which they act. These prohibitions are imposed upon fiduciaries to deter them from exercising the authority, control, or responsibility which makes such persons fiduciaries when they have interests which may conflict with the interests of the plans for which they act. In such cases, the fiduciaries have interests in the transactions which may affect the exercise of their best judgment as fiduciaries. Thus, a fiduciary may not use the authority,

control, or responsibility which makes such person a fiduciary to cause a plan to pay an additional fee to such fiduciary (or to a person in which such fiduciary has an interest which may affect the exercise of such fiduciary's best judgment as a fiduciary) to provide a service. Nor may a fiduciary use such authority, control, or responsibility to cause a plan to enter into a transaction involving plan assets whereby such fiduciary (or a person in which such fiduciary has an interest which may affect the exercise of such fiduciary's best judgment as a fiduciary) will receive consideration from a third party in connection with such transaction. A person in which a fiduciary has an interest which may affect the exercise of such fiduciary's best judgment as a fiduciary includes, for example, a person who is a party in interest by reason of a relationship to such fiduciary described in section 3(14)(E), (F), (G), (H), or (I).

(2) *Transactions not described in section 406(b)(1)*. A fiduciary does not engage in an act described in section 406(b)(1) of the Act if the fiduciary does not use any of the authority, control or responsibility which makes such person a fiduciary to cause a plan to pay additional fees for a service furnished by such fiduciary or to pay a fee for a service furnished by a person in which such fiduciary has an interest which may affect the exercise of such fiduciary's best judgment as a fiduciary. This may occur, for example, when one fiduciary is retained on behalf of a plan by a second fiduciary to provide a service for an additional fee. However, because the authority, control or responsibility which makes a person a fiduciary may be exercised "in effect" as well as in form, mere approval of the transaction by a second fiduciary does not mean that the first fiduciary has not used any of the authority, control or responsibility which makes such person a fiduciary to cause the plan to pay the first fiduciary an additional fee for a service. See paragraph (f) of this section.

(3) *Services without compensation*. If a fiduciary provides services to a plan without the receipt of compensation or other consideration (other than reimbursement of direct expenses properly

and actually incurred in the performance of such services within the meaning of § 2550.408c-2(b)(3)), the provision of such services does not, in and of itself, constitute an act described in section 406(b) of the Act. The allowance of a deduction to an employer under section 162 or 212 of the Code for the expense incurred in furnishing office space or services to a plan established or maintained by such employer does not constitute compensation or other consideration.

(f) *Examples*. The provisions of § 2550.408b-2(e) may be illustrated by the following examples.

Example 1. E, an employer whose employees are covered by plan P, is a fiduciary of P. I is a professional investment adviser in which E has no interest which may affect the exercise of E's best judgment as a fiduciary. E causes P to retain I to provide certain kinds of investment advisory services of a type which causes I to be a fiduciary of P under section 3(21)(A)(ii) of the Act. thereafter, I proposes to perform for additional fees portfolio evaluation services in addition to the services currently provided. The provision of such services is arranged by I and approved on behalf of the plan by E. I has not engaged in an act described in section 406(b)(1) of the Act, because I did not use any of the authority, control or responsibility which makes I a fiduciary (the provision of investment advisory services) to cause the plan to pay I additional fees for the provision of the portfolio evaluation services. E has not engaged in an act which is described in section 406(b)(1). E, as the fiduciary who has the responsibility to be prudent in his selection and retention of I and the other investment advisers of the plan, has an interest in the purchase by the plan of portfolio evaluation services. However, such an interest is not an interest which may affect the exercise of E's best judgment as a fiduciary.

Example 2. D, a trustee of plan P with discretion over the management and disposition of plan assets, relies on the advice of C, a consultant to P, as to the investment of plan assets, thereby making C a fiduciary of the plan. On January 1, 1978, C recommends to D that the plan purchase an insurance policy from U, an insurance company which is not a party in interest with respect to P. C thoroughly explains the reasons for the recommendation and makes a full disclosure concerning the fact that C will receive a commission from U upon the purchase of the policy of P. D considers the recommendation and approves the purchase of the policy by P. C receives a commission. Under such circumstances, C has engaged in an act described in section 406(b)(1) of the Act (as well

as sections 406(b)(2) and (3) of the Act) because C is in fact exercising the authority, control or responsibility which makes C a fiduciary to cause the plan to purchase the policy. However, the transaction is exempt from the prohibited transaction provisions of section 406 of the Act, if the requirements of Prohibited Transaction Exemption 77-9 are met.

Example 3. Assume the same facts as in Example (2) except that the nature of C's relationship with the plan is not such that C is a fiduciary of P. The purchase of the insurance policy does not involve an act described in section 406(b)(1) of the Act (or sections 406(b)(2) or (3) of the Act) because such sections only apply to acts by fiduciaries.

Example 4. E, an employer whose employees are covered by plan P, is a fiduciary with respect to P. A, who is not a party in interest with respect to P, persuades E that the plan needs the services of a professional investment adviser and that A should be hired to provide the investment advice. Accordingly, E causes P to hire A to provide investment advice of the type which makes A a fiduciary under § 2510.3-21(c)(1)(ii)(B). Prior to the expiration of A's first contract with P, A persuades E to cause P to renew A's contract with P to provide the same services for additional fees in view of the increased costs in providing such services. During the period of A's second contract, A provides additional investment advice services for which no additional charge is made. Prior to the expiration of A's second contract, A persuades E to cause P to renew his contract for additional fees in view of the additional services A is providing. A has not engaged in an act described in section 406(b)(1) of the Act, because A has not used any of the authority, control or responsibility which makes A a fiduciary (the provision of investment advice) to cause the plan to pay additional fees for A's services.

Example 5. F, a trustee of plan P with discretion over the management and disposition of plan assets, retains C to provide administrative services to P of the type which makes C a fiduciary under section 3(21)(A)(iii). Thereafter, C retains F to provide for additional fees actuarial and various kinds of administrative services in addition to the services F is currently providing to P. Both F and C have engaged in an act described in section 406(b)(1) of the Act. F, regardless of any intent which he may have had at the time he retained C, has engaged in such an act because F has, in effect, exercised the authority, control or responsibility which makes F a fiduciary to cause the plan to pay F additional fees for the services. C, whose continued employment by P depends on F, has also engaged in such an act, because C has an interest in the transaction which might affect the exercise of C's best judgment as a fiduciary. As a result, C has

dealt with plan assets in his own interest under section 406(b)(1).

Example 6. F, a fiduciary of plan P with discretionary authority respecting the management of P, retains S, the son of F, to provide for a fee various kinds of administrative services necessary for the operation of the plan. F has engaged in an act described in section 406(b)(1) of the Act because S is a person in whom F has an interest which may affect the exercise of F's best judgment as a fiduciary. Such act is not exempt under section 408(b)(2) of the Act irrespective of whether the provision of the services by S is exempt.

Example 7. T, one of the trustees of plan P, is president of bank B. The bank proposes to provide administrative services to P for a fee. T physically absents himself from all consideration of B's proposal and does not otherwise exercise any of the authority, control or responsibility which makes T a fiduciary to cause the plan to retain B. The other trustees decide to retain B. T has not engaged in an act described in section 406(b)(1) of the Act. Further, the other trustees have not engaged in an act described in section 406(b)(1) merely because T is on the board of trustees of P. This fact alone would not make them have an interest in the transaction which might affect the exercise of their best judgment as fiduciaries.

[42 FR 32390, June 24, 1977]

§ 2550.408b-3 Loans to Employee Stock Ownership Plans.

(a) *Definitions.* When used in this section, the terms listed below have the following meanings:

(1) *ESOP.* The term *ESOP* refers to an employee stock ownership plan that meets the requirements of section 407(d)(6) of the Employee Retirement Income Security Act of 1974 (the Act) and 29 CFR 2550.407d-6. It is not synonymous with "stock bonus plan." A stock bonus plan must, however, be an ESOP to engage in an exempt loan. The qualification of an ESOP under section 401 (a) of the Internal Revenue Code (the Code) and 26 CFR 54.4975-11 will not be adversely affected merely because it engages in a non-exempt loan.

(2) *Loan.* The term *loan* refers to a loan made to an ESOP by a party in interest or a loan to an ESOP which is guaranteed by a party in interest. It includes a direct loan of cash, a purchase-money transaction, and an assumption of the obligation of an ESOP. "Guarantee" includes an unsecured guarantee and the use of assets of a

party in interest as collateral for a loan, even though the use of assets may not be a guarantee under applicable state law. An amendment of a loan in order to qualify as an exempt loan is not a refinancing of the loan or the making of another loan.

(3) *Exempt loan.* The term *exempt loan* refers to a loan that satisfies the provisions of this section. A “non-exempt loan” is one that fails to satisfy such provisions.

(4) *Publicly traded.* The term *publicly traded* refers to a security that is listed on a national securities exchange registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f) or that is quoted on a system sponsored by a national securities association registered under section 15A(b) of the Securities Exchange Act (15 U.S.C. 78o).

(5) *Qualifying employer security.* The term *qualifying employer security* refers to a security described in 29 CFR 2550.407d-5.

(b) *Statutory exemption*—(1) *Scope.* Section 408(b)(3) of the Act provides an exemption from the prohibited transaction provisions of sections 406(a) and 406(b)(1) of the Act (relating to fiduciaries dealing with the assets of plans in their own interest or for their own account) and 406(b)(2) of the Act (relating to fiduciaries in their individual or in any other capacity acting in any transaction involving the plan on behalf of a party (or representing a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries). Section 408(b)(3) does not provide an exemption from the prohibitions of section 406(b)(3) of the Act (relating to fiduciaries receiving consideration for their own personal account from any party dealing with a plan in connection with a transaction involving the income or assets of the plan).

(2) *Special scrutiny of transaction.* The exemption under section 408(b)(3) includes within its scope certain transaction in which the potential for self-dealing by fiduciaries exists and in which the interests of fiduciaries may conflict with the interests of participants. To guard against these potential abuses, the Department of Labor will subject these transactions to special

scrutiny to ensure that they are primarily for the benefit of participants and their beneficiaries. Although the transactions need not be arranged and approved by an independent fiduciary, fiduciaries are cautioned to scrupulously exercise their discretion in approving them. For example, fiduciaries should be prepared to demonstrate compliance with the net effect test and the arm’s-length standard under paragraphs (c)(2) and (3) of this section. Also, fiduciaries should determine that the transaction is truly arranged primarily in the interest of participants and their beneficiaries rather than, for example, in the interest of certain selling shareholders.

(c) *Primary benefit requirements*—(1) *In general.* An exempt loan must be primarily for the benefit of the ESOP participants and their beneficiaries. All the surrounding facts and circumstances, including those described in paragraphs (c)(2) and (3) of this section, will be considered in determining whether such loan satisfies this requirement. However, no loan will satisfy such requirement unless it satisfies the requirements of paragraphs (d), (e) and (f) of this section.

(2) *Net effect on plan assets.* At the time that a loan is made, the interest rate for the loan and the price of securities to be acquired with the loan proceeds should not be such that plan assets might be drained off.

(3) *Arm’s-length standard.* The terms of a loan, whether or not between independent parties, must, at the time the loan is made, be at least as favorable to the ESOP as the terms of a comparable loan resulting from arm’s-length negotiations between independent parties.

(d) *Use of loan proceeds.* The proceeds of an exempt loan must be used, within a reasonable time after their receipt, by the borrowing ESOP only for any or all of the following purposes:

(1) To acquire qualifying employer securities.

(2) To repay such loan.

(3) To repay a prior exempt loan. A new loan, the proceeds of which are so used, must satisfy the provisions of this section.

Except as provided in paragraphs (i) and (j) of this section or as otherwise required by applicable law, no security

acquired with the proceeds of an exempt loan may be subject to a put, call, or other option, or buy-sell or similar arrangement while held by and when distributed from a plan, whether or not the plan is then ESOP.

(e) *Liability and collateral of ESOP for loan.* An exempt loan must be without recourse against the ESOP. Furthermore, the only assets of the ESOP that may be given as collateral on an exempt loan are qualifying employer securities of two classes: Those acquired with the proceeds of the exempt loan and those that were used as collateral on a prior exempt loan repaid with the proceeds of the current exempt loan. No person entitled to payment under the exempt loan shall have any right to assets of the ESOP other than:

(1) Collateral given for the loan,

(2) Contributions (other than contributions of employer securities) that are made under an ESOP to meet its obligations under the loan, and

(3) Earnings attributable to such collateral and the investment of such contributions.

The payments made with respect to an exempt loan by the ESOP during a plan year must not exceed an amount equal to the sum of such contributions and earnings received during or prior to the year less such payments in prior years. Such contributions and earnings must be accounted for separately in the books of account of the ESOP until the loan is repaid.

(f) *Default.* In the event of default upon an exempt loan, the value of plan assets transferred in satisfaction of the loan must not exceed the amount of default. If the lender is a party in interest, a loan must provide for a transfer of plan assets upon default only upon and to the extent of the failure of the plan to meet the payment schedule of the loan. For purposes of this paragraph, the making of a guarantee does not make a person a lender.

(g) *Reasonable rate of interest.* The interest rate of a loan must not be in excess of a reasonable rate of interest. All relevant factors will be considered in determining a reasonable rate of interest, including the amount and duration of the loan, the security and guarantee (if any) involved, the credit standing of the ESOP and the guar-

antor (if any), and the interest rate prevailing for comparable loans. When these factors are considered, a variable interest rate may be reasonable.

(h) *Release from encumbrance—(1) General rule.* In general, an exempt loan must provide for the release from encumbrance of plan assets used as collateral for the loan under this paragraph. For each plan year during the duration of the loan, the number of securities released must equal the number of encumbered securities held immediately before release for the current plan year multiplied by a fraction. The numerator of the fraction is the amount of principal and interest paid for the year. The denominator of the fraction is the sum of the numerator plus the principal and interest to be paid for all future years. See § 2550.408b-3(h)(4). The number of future years under the loan must be definitely ascertainable and must be determined without taking into account any possible extensions or renewal periods. If the interest rate under the loan is variable, the interest to be paid in future years must be computed by using the interest rate applicable as of the end of the plan year. If collateral includes more than one class of securities, the number of securities of each class to be released for a plan year must be determined by applying the same fraction to each class.

(2) *Special rule.* A loan will not fail to be exempt merely because the number of securities to be released from encumbrance is determined solely with reference to principal payments. However, if release is determined with reference to principal payments only, the following three additional rules apply. The first rule is that the loan must provide for annual payments of principal and interest at a cumulative rate that is not less rapid at any time than level annual payments of such amounts for 10 years. The second rule is that interest included in any payment is disregarded only to the extent that it would be determined to be interest under standard loan amortization tables. The third rule is that subdivision (2) is not applicable from the time that, by reason of a renewal, extension, or refinancing, the sum of the expired duration of the exempt loan, the renewal

period, the extension period, and the duration of a new exempt loan exceeds 10 years.

(3) *Caution against plan disqualification.* Under an exempt loan, the number of securities released from encumbrance may vary from year to year. The release of securities depends upon certain employer contributions and earnings under the ESOP. Under 26 CFR 54.4975-11(d)(2) actual allocations to participants' accounts are based upon assets withdrawn from the suspense account. Nevertheless, for purposes of applying the limitations under section 415 of the Code to these allocations, under 26 CFR 54.4975-11(a)(8)(ii) contributions used by the ESOP to pay the loan are treated as annual additions to participants' accounts. Therefore, particular caution must be exercised to avoid exceeding the maximum annual additions under section 415 of the Code. At the same time, release from encumbrance in annually varying numbers may reflect a failure on the part of the employer to make substantial and recurring contributions to the ESOP which will lead to loss of qualification under section 401(a) of the Code. The Internal Revenue Service will observe closely the operation of ESOPs that release encumbered securities in varying annual amounts, particularly those that provide for the deferral of loan payments or for balloon payments. See 26 CFR 54.4975-7(b)(8)(iii).

(4) *Illustration.* The general rule under paragraph (h)(1) of this section operates as illustrated in the following examples:

Example. Corporation X establishes an ESOP that borrows \$750,000 from a bank. X guarantees the loan which is for 15 years at 5% interest and is payable in level annual amounts of \$72,256.72. Total payments on the loan are \$1,083,850.80. The ESOP uses the entire proceeds of the loan to acquire 15,000 shares of X stock which is used as collateral for the loan. The number of securities to be released for the first year is 1,000 shares, *i.e.*, $15,000 \text{ shares} \times \$72,256.72 / \$1,083,850.80 = 15,000 \text{ shares} \times \frac{1}{15}$. The number of securities to be released for the second year is 1,000 shares, *i.e.*, $14,000 \text{ shares} \times \$72,256.72 / \$1,011,594.08 = 14,000 \text{ shares} \times \frac{1}{14}$. If all loan payments are made as originally scheduled, the number of securities released in each succeeding year of the loan will also be 1,000.

(i) *Right of first refusal.* Qualifying employer securities acquired with proceeds of an exempt loan may, but need not, be subject to a right of first refusal. However, any such right must meet the requirements of this paragraph. Securities subject to such right must be stock or an equity security, or a debt security convertible into stock or an equity security. Also, they must not be publicly traded at the time the right may be exercised. The right of first refusal must be in favor of the employer, the ESOP, or both in any order of priority. The selling price and other terms under the right must not be less favorable to the seller than the greater of the value of the security determined under 26 CFR 54.4975-11(d)(5), or the purchase price and other terms offered by a buyer, other than the employer or the ESOP, making a good faith offer to purchase the security. The right of first refusal must lapse no later than 14 days after the security holder gives written notice to the holder of the right that an offer by a third party to purchase the security has been received.

(j) *Put option.* A qualifying employer security acquired with the proceeds of an exempt loan by an ESOP after September 30, 1976, must be subject to a put option if it is not publicly traded when distributed or if it is subject to a trading limitation when distributed. For purposes of this paragraph, a "trading limitation" or a security is a restriction under any Federal or State securities law or any regulation thereunder, or an agreement (not prohibited by this section) affecting the security which would make the security not as freely tradeable as one not subject to such restriction. The put option must be exercisable only by a participant, by the participant's donees, or by a person (including an estate or its distributee) to whom the security passes by reason of a participant's death. (Under this paragraph "participant" means a participant and the beneficiaries of the participant under the ESOP.) The put option must permit a participant to put the security to the employer. Under no circumstances may the put option bind the ESOP. However, it may grant the ESOP an option to assume

the rights and obligations of the employer at the time that the put option is exercised. If it is known at the time a loan is made that Federal or state law will be violated by the employer's honoring such put option, the put option must permit the security to be put, in a manner consistent with such law, to a third party (e.g., an affiliate of the employer or a shareholder other than the ESOP) that has substantial net worth at the time the loan is made and whose net worth is reasonably expected to remain substantial.

(k) *Duration of put option*—(1) *General rule.* A put option must be exercisable at least during a 15-month period which begins the date the security subject to the put option is distributed by the ESOP.

(2) *Special rule.* In the case of a security that is publicly traded without restriction when distributed but ceases to be so traded within 15 months after distribution, the employer must notify each security holder in writing on or before the tenth day after the date the security ceases to be so traded that for the remainder of the 15-month period the security is subject to a put option. The number of days between the tenth day and the date on which notice is actually given, if later than the tenth day, must be added to the duration of the put option. The notice must inform distributees of the terms of the put options that they are to hold. The terms must satisfy the requirements of paragraphs (j) through (l) of this section.

(1) *Other put option provisions*—(1) *Manner of exercise.* A put option is exercised by the holder notifying the employer in writing that the put option is being exercised.

(2) *Time excluded from duration of put option.* The period during which a put option is exercisable does not include any time when a distributee is unable to exercise it because the party bound by the put option is prohibited from honoring it by applicable Federal or State law.

(3) *Price.* The price at which a put option must be exercisable is the value of the security, determined in accordance with paragraph (d)(5) of 26 CFR 54.4975-11.

(4) *Payment terms.* The provisions for payment under a put option must be

reasonable. The deferral of payment is reasonable if adequate security and a reasonable interest rate are provided for any credit extended and if the cumulative payments at any time are no less than the aggregate of reasonable periodic payments as of such time. Periodic payments are reasonable if annual installments, beginning with 30 days after the date the put option is exercised, are substantially equal. Generally, the payment period may not end more than 5 years after the date the put option is exercised. However, it may be extended to a date no later than the earlier of 10 years from the date the put option is exercised or the date the proceeds of the loan used by the ESOP to acquire the security subject to such put option are entirely repaid.

(5) *Payment restrictions.* Payment under a put option may be restricted by the terms of a loan, including one used to acquire a security subject to a put option, made before November 1, 1977. Otherwise, payment under a put option must not be restricted by the provisions of a loan or any other arrangement, including the terms of the employer's articles of incorporation, unless so required by applicable state law.

(m) *Other terms of loan.* An exempt loan must be for a specific term. Such loan may not be payable at the demand of any person, except in the case of default.

(n) *Status of plan as ESOP.* To be exempt, a loan must be made to a plan that is an ESOP at the time of such loan. However, a loan to a plan formally designated as an ESOP at the time of the loan that fails to be an ESOP because it does not comply with section 401(a) of the Code or 26 CFR 54.4975-11 will be exempt as of the time of such loan if the plan is amended retroactively under section 401(b) of the Code or 26 CFR 54.4975-11(a)(4).

(o) *Special rules for certain loans*—(1) *Loans made before January 1, 1976.* A loan made before January 1, 1976, or made afterwards under a binding agreement in effect on January 1, 1976 (or under renewals permitted by the terms of such an agreement on that date) is exempt for the entire period of such

loan if it otherwise satisfies the provisions of this section for such period, even though it does not satisfy the following provisions of this section:

- (i) The last sentence of paragraph (d);
- (ii) Paragraphs (e), (f), and (h)(1) and (2); and
- (iii) Paragraphs (i) through (m), inclusive.

(2) *Loans made after December 31, 1975, but before November 1, 1977.* A loan made after December 31, 1975, but before November 1, 1977, or made afterwards under a binding agreement in effect on November 1, 1977 (or under renewals permitted by the terms of such an agreement on that date) is exempt for the entire period of such loan if it otherwise satisfies the provisions of this section for such period even though it does not satisfy the following provisions of this section:

- (i) Paragraph (f);
- (ii) The three provisions of paragraph (h)(2); and
- (iii) Paragraph (i).

(3) *Release rule.* Notwithstanding paragraphs (o)(1) and (2) of this section, if the proceeds of a loan are used to acquire securities after November 1, 1977, the loan must comply by such date with the provisions of paragraph (h) of this section.

(4) *Default rule.* Notwithstanding paragraphs (o)(1) and (2) of this section, a loan by a party in interest other than a guarantor must satisfy the requirements of paragraph (f) of this section. A loan will satisfy these requirements if it is retroactively amended before November 1, 1977, to satisfy these requirements.

(5) *Put option rule.* With respect to a security distributed before November 1, 1977, the put option provisions of paragraphs (j), (k), and (l) of this section will be deemed satisfied as of the date the security is distributed if by December 31, 1977, the security is subject to a put option satisfying such provisions. For purposes of satisfying such provisions, the security will be deemed distributed on the date the put option is issued. However, the put option provisions need not be satisfied with respect to a security that is not owned on No-

vember 1, 1977, by a person in whose hands a put option must be exercisable.

(Approved by the Office of Management and Budget under control number 1210-0046)

[42 FR 44385, Sept. 2, 1977; 42 FR 45907, Sept. 13, 1977, as amended at 49 FR 18295, Apr. 30, 1984]

§ 2550.408b-4 Statutory exemption for investments in deposits of banks or similar financial institutions.

(a) *In general.* Section 408(b)(4) of the Employee Retirement Income Security Act of 1974 (the Act) exempts from the prohibitions of section 406 of the Act the investment of all or a part of a plan's assets in deposits bearing a reasonable rate of interest in a bank or similar financial institution supervised by the United States or a State, even though such bank or similar financial institution is a fiduciary or other party in interest with respect to the plan, if the conditions of either § 2550.408b-4(b)(1) or § 2550.408b-4(b)(2) are met. Section 408(b)(4) provides an exemption from sections 406(b)(1) of the Act (relating to fiduciaries dealing with the assets of plans in their own interest or for their own account) and 406(b)(2) of the Act (relating to fiduciaries in their individual or in any other capacity acting in any transaction involving the plan on behalf of a party (or representing a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries), as well as section 406(a)(1), because section 408(b)(4) contemplates a bank or similar financial institution causing a plan for which it acts as a fiduciary to invest plan assets in its own deposits if the requirements of section 408(b)(4) are met. However, it does not provide an exemption from section 406(b)(3) of the Act (relating to fiduciaries receiving consideration for their own personal account from any party dealing with a plan in connection with a transaction involving the assets of the plan). The receipt of such consideration is a separate transaction not described in the statutory exemption. Section 408(b)(4) does not contain an exemption from other provisions of the Act, such as section 404, or other provisions of law which may impose requirements or restrictions relating to the transactions which are exempt under

section 408(b)(4) of the Act. See, for example, section 401 of the Internal Revenue Code of 1954 (Code). The provisions of section 408(b)(4) of the Act are further limited by section 408(d) of the Act (relating to transactions with owner-employees and related persons).

(b)(1) *Plan covering own employees.* Such investment may be made if the plan is one which covers only the employees of the bank or similar financial institution, the employees of any of its affiliates, or the employees of both.

(2) *Other plans.* Such investment may be made if the investment is expressly authorized by a provision of the plan or trust instrument or if the investment is expressly authorized (or made) by a fiduciary of the plan (other than the bank or similar financial institution or any of its affiliates) who has authority to make such investments, or to instruct the trustee or other fiduciary with respect to investments, and who has no interest in the transaction which may affect the exercise of such authorizing fiduciary's best judgment as a fiduciary so as to cause such authorization to constitute an act described in section 406(b) of the Act. Any authorization to make investments contained in a plan or trust instrument will satisfy the requirement of express authorization for investments made prior to November 1, 1977. Effective November 1, 1977, in the case of a bank or similar financial institution that invests plan assets in deposits in itself or its affiliates under an authorization contained in a plan or trust instrument, such authorization must name such bank or similar financial institution and must state that such bank or similar financial institution may make investments in deposits which bear a reasonable rate of interest in itself (or in an affiliate).

(3) *Example.* B, a bank, is the trustee of plan P's assets. The trust instruments give the trustees the right to invest plan assets in its discretion. B invests in the certificates of deposit of bank C, which is a fiduciary of the plan by virtue of performing certain custodial and administrative services. The authorization is sufficient for the plan to make such investment under section 408(b)(4). Further, such authorization would suffice to allow B to make in-

vestments in deposits in itself prior to November 1, 1977. However, subsequent to October 31, 1977, B may not invest in deposits in itself, unless the plan or trust instrument specifically authorizes it to invest in deposits of B.

(c) *Definitions.* (1) The term *bank or similar financial institution* includes a bank (as defined in section 581 of the Code), a domestic building and loan association (as defined in section 7701(a)(19) of the Code), and a credit union (as defined in section 101(6) of the Federal Credit Union Act).

(2) A person is an affiliate of a bank or similar financial institution if such person and such bank or similar financial institution would be treated as members of the same controlled group of corporations or as members of two or more trades or businesses under common control within the meaning of section 414 (b) or (c) of the Code and the regulations thereunder.

(3) The term *deposits* includes any account, temporary or otherwise, upon which a reasonable rate of interest is paid, including a certificate of deposit issued by a bank or similar financial institution.

[42 FR 32392, June 24, 1977; 42 FR 36823, July 18, 1977]

§ 2550.408b-6 Statutory exemption for ancillary services by a bank or similar financial institution.

(a) *In general.* Section 408(b)(6) of the Employee Retirement Income Security Act of 1974 (the Act) exempts from the prohibitions of section 406 of the Act the provision of certain ancillary services by a bank or similar financial institution (as defined in § 2550.408b-4(c)(1) supervised by the United States or a State to a plan for which it acts as a fiduciary if the conditions of § 2550.408b-6(b) are met. Such ancillary services include services which do not meet the requirements of section 408(b)(2) of the Act because the provision of such services involves an act described in section 406(b)(1) of the Act (relating to fiduciaries dealing with the assets of plans in their own interest or for their own account) by the fiduciary bank or similar financial institution or an act described in section 406(b)(2) of the Act (relating to fiduciaries in their individual or in any

other capacity acting in any transaction involving the plan on behalf of a party (or representing a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries). Section 408(b)(6) provides an exemption from sections 406(b)(1) and (2) because section 408(b)(6) contemplates the provision of such ancillary services without the approval of a second fiduciary (as described in §2550.408b-2(e)(2)) if the conditions of §2550.408b-6(b) are met. Thus, for example, plan assets held by a fiduciary bank which are reasonably expected to be needed to satisfy current plan expenses may be placed by the bank in a non-interest-bearing checking account in the bank if the conditions of §2550.408b-6(b) are met, notwithstanding the provisions of section 408(b)(4) of the Act (relating to investments in bank deposits). However, section 408(b)(6) does not provide an exemption for an act described in section 406(b)(3) of the Act (relating to fiduciaries receiving consideration for their own personal account from any party dealing with a plan in connection with a transaction involving the assets of the plan). The receipt of such consideration is a separate transaction not described in section 408(b)(6). Section 408(b)(6) does not contain an exemption from other provisions of the Act, such as section 404, or other provisions of law which may impose requirements or restrictions relating to the transactions which are exempt under section 408(b)(6) of the Act. See, for example, section 401 of the Internal Revenue Code of 1954. The provisions of section 408(b)(6) of the Act are further limited by section 408(d) of the Act (relating to transactions with owner-employees and related persons).

(b) *Conditions.* Such service must be provided—

(1) At not more than reasonable compensation;

(2) Under adequate internal safeguards which assure that the provision of such service is consistent with sound banking and financial practice, as determined by Federal or State supervisory authority; and

(3) Only to the extent that such service is subject to specific guidelines issued by the bank or similar financial

institution which meet the requirements of §2550.408b-6(c).

[42 FR 32392, June 24, 1977; 42 FR 36823, July 18, 1977]

§ 2550.408b-19 Statutory exemption for cross-trading of securities.

(a) *In general.* (1) Section 408(b)(19) of the Employee Retirement Income Security Act of 1974 (the Act) exempts from the prohibitions of section 406(a)(1)(A) and 406(b)(2) of the Act any cross-trade of securities if certain conditions are satisfied. Among other conditions, the exemption requires that the investment manager adopt, and effect cross-trades in accordance with, written cross-trading policies and procedures that are fair and equitable to all accounts participating in the cross-trading program, and that include:

(i) A description of the investment manager's pricing policies and procedures; and

(ii) The investment manager's policies and procedures for allocating cross-trades in an objective manner among accounts participating in the cross-trading program.

(2) Section 4975(d)(22) of the Internal Revenue Code of 1986 (the Code) contains parallel provisions to section 408(b)(19) of the Act. Effective December 31, 1978, section 102 of Reorganization Plan No. 4 of 1978, 5 U.S.C. App. 214 (2000 ed.), transferred the authority of the Secretary of the Treasury to promulgate regulations of the type published herein to the Secretary of Labor. Therefore, all references herein to section 408(b)(19) of the Act should be read to include reference to the parallel provisions of section 4975(d)(22) of the Code.

(3) Section 408(b)(19)(D) of the Act requires that a plan fiduciary for each plan participating in the cross-trades receive in advance of any cross-trades disclosure regarding the conditions under which the cross-trades may take place, including the written policies and procedures described in section 408(b)(19)(H) of the Act. This disclosure must be in a document that is separate from any other agreement or disclosure involving the asset management relationship. For purposes of section 408(b)(19)(D) of the Act, the policies and procedures furnished to the authorizing

fiduciary must conform with the requirements of this regulation.

(4) The standards set forth in this section apply solely for purposes of determining whether an investment manager's written policies and procedures satisfy the content requirements of section 408(b)(19)(H) of the Act. Accordingly, such standards do not determine whether the investment manager satisfies the other requirements for relief under section 408(b)(19) of the Act.

(b)(1) *Policies and procedures. In general.* This paragraph specifies the content of the written policies and procedures required to be adopted by an investment manager and disclosed to the plan fiduciary prior to authorizing cross-trading in order for transactions to qualify for relief under section 408(b)(19) of the Act.

(2) *Style and format.* The content of the policies and procedures required by this paragraph must be clear and concise and written in a manner calculated to be understood by the plan fiduciary authorizing cross-trading. Although no specific format is required for the investment manager's written policies and procedures, the information contained in the policies and procedures must be sufficiently detailed to facilitate a periodic review by the compliance officer of the cross-trades and a determination by such compliance officer that the cross-trades comply with the investment manager's written cross-trading policies and procedures.

(3) *Content* (i). An investment manager's policies and procedures must be fair and equitable to all accounts participating in its cross-trading program and reasonably designed to ensure compliance with the requirements of section 408(b)(19)(H) of the Act. Such policies and procedures must include:

(A) A statement of policy which describes the criteria that will be applied by the investment manager in determining that execution of a securities transaction as a cross-trade will be beneficial to both parties to the transaction;

(B) A description of how the investment manager will determine that cross-trades are effected at the independent "current market price" of the security (within the meaning of section 270.17a-7(b) of Title 17, Code of Federal

Regulations and SEC no-action and interpretative letters thereunder) as required by section 408(b)(19)(B) of the Act, including the identity of sources used to establish such price;

(C) A description of the procedures for ensuring compliance with the \$100,000,000 minimum asset size requirement of section 408(b)(19). A plan or master trust will satisfy the minimum asset size requirement as to a transaction if it satisfies the requirement upon its initial participation in the cross-trading program and on an annual basis thereafter;

(D) A statement that any investment manager participating in a cross-trading program will have conflicting loyalties and responsibilities to the parties involved in any cross-trade transaction and a description of how the investment manager will mitigate such conflicts;

(E) A requirement that the investment manager allocate cross-trades among accounts in an objective and equitable manner and a description of the allocation method(s) available to and used by the investment manager for assuring an objective allocation among accounts participating in the cross-trading program. If more than one allocation methodology may be used by the investment manager, a description of what circumstances will dictate the use of a particular methodology;

(F) Identification of the compliance officer responsible for periodically reviewing the investment manager's compliance with section 408(b)(19)(H) of the Act and a statement of the compliance officer's qualifications for this position;

(G) A statement that the cross-trading statutory exemption under section 408(b)(19) of the Act requires satisfaction of several objective conditions in addition to the requirements that the investment manager adopt and effect cross-trades in accordance with written cross-trading policies and procedures; and

(H) A statement which specifically describes the scope of the annual review conducted by the compliance officer.

(ii) Nothing herein is intended to preclude an investment manager from including such other policies and procedures not required by this regulation as the investment manager may determine appropriate to comply with the requirements of section 408(b)(19).

(c) *Definitions.* For purposes of this section:

(1) The term “*account*” includes any single customer or pooled fund or account.

(2) The term “*compliance officer*” means an individual designated by the investment manager who is responsible for periodically reviewing the cross-trades made for the plan to ensure compliance with the investment manager’s written cross-trading policies and procedures and the requirements of section 408(b)(19)(H) of the Act.

(3) The term “*plan fiduciary*” means a person described in section 3(21)(A) of the Act with respect to a plan (other than the investment manager engaging in the cross-trades or an affiliate) who has the authority to authorize a plan’s participation in an investment manager’s cross-trading program.

(4) The term “*investment manager*” means a person described in section 3(38) of the Act.

(5) The term “*plan*” means any employee benefit plan as described in section 3(3) of the Act to which Title I of the Act applies or any plan defined in section 4975(e)(1) of the Code.

(6) The term “*cross-trade*” means the purchase and sale of a security between a plan and any other account managed by the same investment manager.

[73 FR 58458, Oct. 7, 2008]

§ 2550.408c-2 Compensation for services.

(a) *In general.* Section 408(b)(2) of the Employee Retirement Income Security Act of 1974 (the Act) refers to the payment of reasonable compensation by a plan to a party in interest for services rendered to the plan. Section 408(c)(2) of the Act and §§ 2550.408c-2(b)(1) through 2550.408c-2(b)(4) clarify what constitutes reasonable compensation for such services.

(b)(1) *General rule.* Generally, whether compensation is “reasonable” under sections 408 (b)(2) and (c)(2) of the Act

depends on the particular facts and circumstances of each case.

(2) *Payments to certain fiduciaries.* Under sections 408(b)(2) and 408(c)(2) of the Act, the term “reasonable compensation” does not include any compensation to a fiduciary who is already receiving full-time pay from an employer or association of employers (any of whose employees are participants in the plan) or from an employee organization (any of whose members are participants in the plan), except for the reimbursement of direct expenses properly and actually incurred and not otherwise reimbursed. The restrictions of this paragraph (b)(2) do not apply to a party in interest who is not a fiduciary.

(3) *Certain expenses not direct expenses.* An expense is not a direct expense to the extent it would have been sustained had the service not been provided or if it represents an allocable portion of overhead costs.

(4) *Expense advances.* Under sections 408(b)(2) and 408(c)(2) of the Act, the term “reasonable compensation,” as applied to a fiduciary or an employee of a plan, includes an advance to such a fiduciary or employee by the plan to cover direct expenses to be properly and actually incurred by such person in the performance of such person’s duties with the plan if:

(i) The amount of such advance is reasonable with respect to the amount of the direct expense which is likely to be properly and actually incurred in the immediate future (such as during the next month); and

(ii) The fiduciary or employee accounts to the plan at the end of the period covered by the advance for the expenses properly and actually incurred.

(5) *Excessive compensation.* Under sections 408(b)(2) and 408(c)(2) of the Act, any compensation which would be considered excessive under 26 CFR 1.162-7 (Income Tax Regulations relating to compensation for personal services which constitutes an ordinary and necessary trade or business expense) will not be “reasonable compensation.” Depending upon the facts and circumstances of the particular situation, compensation which is not excessive under 26 CFR 1.162-7 may, nevertheless, not be “reasonable compensation”

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within the meaning of sections 408(b)(2) and 408 (c)(2) of the Act.

[42 FR 32393, June 24, 1977]

§ 2550.408e Statutory exemption for acquisition or sale of qualifying employer securities and for acquisition, sale, or lease of qualifying employer real property.

(a) *General.* Section 408(e) of the Employee Retirement Income Security Act of 1974 (the Act) exempts from the prohibitions of section 406(a) and 406(b)(1) and (2) of the Act any acquisition or sale by a plan of qualifying employer securities (as defined in section 407(d)(5) of the Act), or any acquisition, sale or lease by a plan of qualifying employer real property (as defined in section 407(d)(4) of the Act) if certain conditions are met. The conditions are that:

(1) The acquisition, sale or lease must be for adequate consideration (which is defined in paragraph (d) of this section);

(2) No commission may be charged directly or indirectly to the plan with respect to the transaction; and

(3) In the case of an acquisition or lease of qualifying employer real property, or an acquisition of qualifying employer securities, by a plan other than an eligible individual account plan (as defined in section 407(d)(3) of the Act), the acquisition or lease must comply with the requirements of section 407(a) of the Act.

(b) *Acquisition.* For purposes of section 408(e) and this section, an acquisition by a plan of qualifying employer securities or qualifying employer real property shall include, but not be limited to, an acquisition by purchase, by the exchange of plan assets, by the exercise of warrants or rights, by the conversion of a security, by default of a loan where the qualifying employer security or qualifying employer real property was security for the loan, or in connection with the contribution of such securities or real property to the plan. However, an acquisition of a security shall not be deemed to have occurred if a plan acquires the security as a result of a stock dividend or stock split.

(c) *Sale.* For purposes of section 408(e) and this section, a sale of qualifying

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employer real property or qualifying employer securities shall include any disposition for value.

(d) *Adequate consideration.* For purposes of section 408(e) and this section, adequate consideration means:

(1) In the case of a marketable obligation, a price not less favorable to the plan than the price determined under section 407(e)(1) of the Act; and

(2) In all other cases, a price not less favorable to the plan than the price determined under section 3(18) of the Act.

(e) *Commission.* For purposes of section 408(e) and this section, the term “commission” includes any fee, commission or similar charge paid in connection with a transaction, except that the term “commission” does not include a charge incurred for the purpose of enabling the appropriate plan fiduciaries to evaluate the desirability of entering into a transaction to which this section would apply, such as an appraisal or investment advisory fee.

[45 FR 51197, Aug. 1, 1980]

§ 2550.408g-1 Investment advice—participants and beneficiaries.

(a) *In general.* (1) This section provides relief from the prohibitions of section 406 of the Employee Retirement Income Security Act of 1974, as amended (ERISA or the Act), and section 4975 of the Internal Revenue Code of 1986, as amended (the Code), for certain transactions in connection with the provision of investment advice to participants and beneficiaries. This section, at paragraph (b), implements the statutory exemption set forth at sections 408(b)(14) and 408(g)(1) of ERISA and sections 4975(d)(17) and 4975(f)(8) of the Code. This section, at paragraph (d), prescribes, pursuant to section 408(a) of ERISA and section 4975(c)(2) of the Code, a class exemption for certain transactions not otherwise covered by the statutory exemption. The requirements and conditions set forth in this section apply solely for the relief described in paragraphs (b) and (d) of this section and, accordingly, no inferences should be drawn with respect to requirements applicable to the provision of investment advice not addressed by this section.

(2) Nothing contained in ERISA section 408(g)(1), Code section 4975(f)(8),

this regulation or the class exemption contained herein imposes an obligation on a plan fiduciary or any other party to offer, provide or otherwise make available any investment advice to a participant or beneficiary.

(3) Nothing contained in ERISA section 408(g)(1), Code section 4975(f)(8), this regulation or the class exemption contained herein invalidates or otherwise affects prior regulations, exemptions, interpretive or other guidance issued by the Department of Labor pertaining to the provision of investment advice and the circumstances under which such advice may or may not constitute a prohibited transaction under section 406 of ERISA or section 4975 of the Code.

(b) *Statutory exemption.*—(1) *General.* Sections 408(b)(14) and 408(g)(1) of ERISA provide an exemption from the prohibitions of section 406 of ERISA for transactions described in section 408(b)(14) of ERISA in connection with the provision of investment advice to a participant or a beneficiary if the investment advice is provided by a fiduciary adviser under an “eligible investment advice arrangement.” Sections 4975(d)(17) and (f)(8) of the Code contain parallel provisions to ERISA sections 408(b)(14) and (g)(1).

(2) *Eligible investment advice.* For purposes of section 408(g)(1) of ERISA and section 4975(f)(8) of the Code, an “eligible investment advice arrangement” means an arrangement that meets either the requirements of paragraph (b)(3) of this section or paragraph (b)(4) of this section, or both.

(3) Arrangements that use fee-leveling. For purposes of this section, an arrangement is an eligible investment advice arrangement if—

(i)(A) Any investment advice is based on generally accepted investment theories that take into account the historic returns of different asset classes over defined periods of time, although nothing herein shall preclude any investment advice from being based on generally accepted investment theories that take into account additional considerations;

(B) Any investment advice takes into account investment management and other fees and expenses attendant to the recommended investments;

(C) Any investment advice takes into account, to the extent furnished by a plan, participant or beneficiary, information relating to age, time horizons (e.g., life expectancy, retirement age), risk tolerance, current investments in designated investment options, other assets or sources of income, and investment preferences of the participant or beneficiary. A fiduciary adviser shall request such information, but nothing in this paragraph (b)(3)(i)(C) shall require that any investment advice take into account information requested, but not furnished by a participant or beneficiary, nor preclude requesting and taking into account additional information that a plan or participant or beneficiary may provide;

(D) Any fees or other compensation (including salary, bonuses, awards, promotions, commissions or other things of value) received, directly or indirectly, by any employee, agent or registered representative that provides investment advice on behalf of a fiduciary adviser does not vary depending on the basis of any investment option selected by a participant or beneficiary;

(E) Any fees (including any commission or other compensation) received by the fiduciary adviser for investment advice or with respect to the sale, holding, or acquisition of any security or other property for purposes of investment of plan assets do not vary depending on the basis of any investment option selected by a participant or beneficiary; and

(ii) The requirements of paragraphs (b)(5), (6), (7), and (8) and paragraph (e) of this section are met.

(4) *Arrangements that use computer models.* For purposes of this section, an arrangement is an eligible investment advice arrangement if the only investment advice provided under the arrangement is advice that is generated by a computer model described in paragraphs (b)(4)(i) and (ii) of this section under an investment advice program and with respect to which the requirements of paragraphs (b)(5), (6), (7), and (8) and paragraph (e) are met.

(i) A computer model shall be designed and operated to—

(A) Apply generally accepted investment theories that take into account

the historic returns of different asset classes over defined periods of time, although nothing herein shall preclude a computer model from applying generally accepted investment theories that take into account additional considerations;

(B) Take into account investment management and other fees and expenses attendant to the recommended investments;

(C) Request from a participant or beneficiary and, to the extent furnished, utilize information relating to age, time horizons (e.g., life expectancy, retirement age), risk tolerance, current investments in designated investment options, other assets or sources of income, and investment preferences; provided, however, that nothing herein shall preclude a computer model from requesting and taking into account additional information that a plan or a participant or beneficiary may provide;

(D) Utilize appropriate objective criteria to provide asset allocation portfolios comprised of investment options available under the plan;

(E) Avoid investment recommendations that:

(1) Inappropriately favor investment options offered by the fiduciary adviser or a person with a material affiliation or material contractual relationship with the fiduciary adviser over other investment options, if any, available under the plan; or

(2) Inappropriately favor investment options that may generate greater income for the fiduciary adviser or a person with a material affiliation or material contractual relationship with the fiduciary adviser; and

(F)(1) Except as provided in clause (2) of this paragraph (F), take into account all designated investment options, within the meaning of paragraph (c)(1) of this section, available under the plan without giving inappropriate weight to any investment option.

(2) A computer model shall not be treated as failing to meet the requirements of this paragraph merely because it does not make recommendations relating to the acquisition, holding or sale of an investment option that:

(i) Constitutes an investment primarily in qualifying employer securities;

(ii) Constitutes an investment fund, product or service that allocates the invested assets of a participant or beneficiary to achieve varying degrees of long-term appreciation and capital preservation through equity and fixed income exposures, based on a defined time horizon (such as retirement age or life expectancy) or level of risk of the participant or beneficiary, provided that, contemporaneous with the provision of investment advice generated by the computer model, the participant or beneficiary is also furnished a general description of such funds, products or services and how they operate; or

(iii) Constitutes an annuity option with respect to which a participant or beneficiary may allocate assets toward the purchase of a stream of retirement income payments guaranteed by an insurance company, provided that, contemporaneous with the provision of investment advice generated by the computer model, the participant or beneficiary is also furnished a general description of such options and how they operate.

(ii) Prior to utilization of the computer model, the fiduciary adviser shall obtain a written certification, meeting the requirements of paragraph (b)(4)(iv) of this section, from an eligible investment expert, within the meaning of paragraph (b)(4)(iii) of this section, that the computer model meets the requirements of paragraph (b)(4)(i) of this section. If, following certification, a computer model is modified in a manner that may affect its ability to meet the requirements of paragraph (b)(4)(i), the fiduciary adviser shall, prior to utilization of the modified model, obtain a new certification from an eligible investment expert that the computer model, as modified, meets the requirements of paragraph (b)(4)(i).

(iii) The term “eligible investment expert” means a person that, through employees or otherwise, has the appropriate technical training or experience and proficiency to analyze, determine and certify, in a manner consistent with paragraph (b)(4)(iv) of this section, whether a computer model meets the requirements of paragraph (b)(4)(i)

of this section; except that the term “eligible investment expert” does not include any person that has any material affiliation or material contractual relationship with the fiduciary adviser, with a person with a material affiliation or material contractual relationship with the fiduciary adviser, or with any employee, agent, or registered representative of the foregoing.

(iv) A certification by an eligible investment expert shall—

(A) Be in writing;

(B) Contain—

(1) An identification of the methodology or methodologies applied in determining whether the computer model meets the requirements of paragraph (b)(4)(i) of this section;

(2) An explanation of how the applied methodology or methodologies demonstrated that the computer model met the requirements of paragraph (b)(4)(i) of this section;

(3) A description of any limitations that were imposed by any person on the eligible investment expert’s selection or application of methodologies for determining whether the computer model meets the requirements of paragraph (b)(4)(i) of this section;

(4) A representation that the methodology or methodologies were applied by a person or persons with the educational background, technical training or experience necessary to analyze and determine whether the computer model meets the requirements of paragraph (b)(4)(i); and

(5) A statement certifying that the eligible investment expert has determined that the computer model meets the requirements of paragraph (b)(4)(i) of this section; and

(C) Be signed by the eligible investment expert.

(v) The selection of an eligible investment expert as required by this section is a fiduciary act governed by section 404(a)(1) of ERISA.

(5) *Arrangement must be authorized by a plan fiduciary.* (i) Except as provided in paragraph (b)(5)(ii), the arrangement pursuant to which investment advice is provided to participants and beneficiaries pursuant to this section must be expressly authorized by a plan fiduciary (or, in the case of an Individual Retirement Account (IRA), the IRA

beneficiary) other than: The person offering the arrangement; any person providing designated investment options under the plan; or any affiliate of either. Provided, however, that for purposes of the preceding, in the case of an IRA, an IRA beneficiary will not be treated as an affiliate of a person solely by reason of being an employee of such person.

(ii) In the case of an arrangement pursuant to which investment advice is provided to participants and beneficiaries of a plan sponsored by the person offering the arrangement or a plan sponsored by an affiliate of such person, the authorization described in paragraph (b)(5)(i) may be provided by the plan sponsor of such plan, provided that the person or affiliate offers the same arrangement to participants and beneficiaries of unaffiliated plans in the ordinary course of its business.

(iii) For purposes of the authorization described in paragraph (b)(5)(i), a plan sponsor shall not be treated as a person providing a designated investment option under the plan merely because one of the designated investment options of the plan is an option that permits investment in securities of the plan sponsor or an affiliate.

(6) *Annual audit.* (i) The fiduciary adviser shall, at least annually, engage an independent auditor, who has appropriate technical training or experience and proficiency, and so represents in writing to the fiduciary adviser, to:

(A) Conduct an audit of the investment advice arrangements for compliance with the requirements of this section; and

(B) Within 60 days following completion of the audit, issue a written report to the fiduciary adviser and, except with respect to an arrangement with an IRA, to each fiduciary who authorized the use of the investment advice arrangement, in accordance with paragraph (b)(5) of this section, setting forth the specific findings of the auditor regarding compliance of the arrangement with the requirements of this section.

(ii) With respect to an arrangement with an IRA, the fiduciary adviser:

(A) Within 30 days following receipt of the report from the auditor, as described in paragraph (b)(6)(i)(B) of this

section, shall furnish a copy of the report to the IRA beneficiary or make such report available on its Web site, provided that such beneficiaries are provided information, with the information required to be disclosed pursuant to paragraph (b)(7) of this section, concerning the purpose of the report, and how and where to locate the report applicable to their account; and

(B) In the event that the report of the auditor identifies noncompliance with the requirements of this section, within 30 days following receipt of the report from the auditor, shall send a copy of the report to the Department of Labor at the following address: Investment Advice Exemption Notification—Statutory, U.S. Department of Labor, Employee Benefits Security Administration, Room N-1513, 200 Constitution Ave., NW., Washington, DC 20210.

(iii) For purposes of this paragraph (b)(6), an auditor is considered independent if it does not have a material affiliation or material contractual relationship with the person offering the investment advice arrangement to the plan or with any designated investment options under the plan.

(iv) For purposes of this paragraph (b)(6), the auditor shall review sufficient relevant information to formulate an opinion as to whether the investment advice arrangements, and the advice provided pursuant thereto, offered by the fiduciary adviser during the audit period were in compliance with this section. Nothing in this paragraph shall preclude an auditor from using information obtained by sampling, as reasonably determined appropriate by the auditor, investment advice arrangements, and the advice pursuant thereto, during the audit period.

(v) The selection of an auditor for purposes of this paragraph (b)(6) is a fiduciary act governed by section 404(a)(1) of ERISA.

(7) *Disclosure.* (i) The fiduciary adviser must provide, without charge, to a participant or a beneficiary before the initial provision of investment advice with regard to any security or other property offered as an investment option, a written notification of:

(A) The role of any party that has a material affiliation or material con-

tractual relationship with the fiduciary adviser in the development of the investment advice program, and in the selection of investment options available under the plan;

(B) The past performance and historical rates of return of the designated investment options available under the plan, to the extent that such information is not otherwise provided;

(C) All fees or other compensation that the fiduciary adviser or any affiliate thereof is to receive (including compensation provided by any third party) in connection with—

(1) The provision of the advice;

(2) The sale, acquisition, or holding of any security or other property pursuant to such advice; or

(3) Any rollover or other distribution of plan assets or the investment of distributed assets in any security or other property pursuant to such advice;

(D) Any material affiliation or material contractual relationship of the fiduciary adviser or affiliates thereof in the security or other property;

(E) The manner, and under what circumstances, any participant or beneficiary information provided under the arrangement will be used or disclosed;

(F) The types of services provided by the fiduciary adviser in connection with the provision of investment advice by the fiduciary adviser, including, with respect to a computer model arrangement referred to in paragraph (b)(4) of this section, any limitations on the ability of a computer model to take into account an investment primarily in qualifying employer securities;

(G) The adviser is acting as a fiduciary of the plan in connection with the provision of the advice; and

(H) That a recipient of the advice may separately arrange for the provision of advice by another adviser that could have no material affiliation with and receive no fees or other compensation in connection with the security or other property.

(ii)(A) The notification required under paragraph (b)(7)(i) of this section must be written in a clear and conspicuous manner and in a manner calculated to be understood by the average plan participant and must be sufficiently accurate and comprehensive to

reasonably apprise such participants and beneficiaries of the information required to be provided in the notification.

(B) The appendix to this section contains a model disclosure form that may be used to provide notification of the information described in paragraph (b)(7)(i)(C) of this section. Use of the model form is not mandatory. However, use of an appropriately completed model disclosure form will be deemed to satisfy the requirements of paragraphs (b)(7)(i) and (ii) of this section with respect to such information.

(iii) The notification required under paragraph (b)(7)(i) of this section may, in accordance with 29 CFR 2520.104b-1, be provided in written or electronic form.

(iv) With respect to the information required to be disclosed pursuant to paragraph (b)(7)(i) of this section, the fiduciary adviser shall, at all times during the provision of advisory services to the participant or beneficiary pursuant to the arrangement,—

(A) Maintain accurate, up-to-date information in a form that is consistent with paragraph (b)(7)(ii) of this section,

(B) Provide, without charge, accurate, up-to-date information to the recipient of the advice no less frequently than annually,

(C) Provide, without charge, accurate information to the recipient of the advice upon request of the recipient, and

(D) Provide, without charge, to the recipient of the advice any material change to the information described in paragraph (b)(7)(i) at a time reasonably contemporaneous to the change in information.

(8) *Other conditions.* The requirements of this paragraph are met if—

(i) The fiduciary adviser provides appropriate disclosure, in connection with the sale, acquisition, or holding of the security or other property, in accordance with all applicable securities laws,

(ii) Any sale, acquisition, or holding of a security or other property occurs solely at the direction of the recipient of the advice,

(iii) The compensation received by the fiduciary adviser and affiliates thereof in connection with the sale, ac-

quisition, or holding of the security or other property is reasonable, and

(iv) The terms of the sale, acquisition, or holding of the security or other property are at least as favorable to the plan as an arm's length transaction would be.

(c) *Definitions.* For purposes of this section:

(1) The term “designated investment option” means any investment option designated by the plan into which participants and beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts. The term “designated investment option” shall not include “brokerage windows,” “self-directed brokerage accounts,” or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by the plan.

(2)(i) The term “fiduciary adviser” means, with respect to a plan, a person who is a fiduciary of the plan by reason of the provision of investment advice referred to in section 3(21)(A)(ii) of ERISA by the person to the participant or beneficiary of the plan and who is—

(A) Registered as an investment adviser under the Investment Advisers Act of 1940 (15 U.S.C. 80b-1 *et seq.*) or under the laws of the State in which the fiduciary maintains its principal office and place of business,

(B) A bank or similar financial institution referred to in section 408(b)(4) of ERISA or a savings association (as defined in section 3(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(1)), but only if the advice is provided through a trust department of the bank or similar financial institution or savings association which is subject to periodic examination and review by Federal or State banking authorities,

(C) An insurance company qualified to do business under the laws of a State,

(D) A person registered as a broker or dealer under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*),

(E) An affiliate of a person described in any of clauses (A) through (D), or

(F) An employee, agent, or registered representative of a person described in paragraphs (c)(2)(i)(A) through (E) of

this section who satisfies the requirements of applicable insurance, banking, and securities laws relating to the provision of advice.

(ii) Except as provided under 29 CFR 2550.408g-2, a fiduciary adviser includes any person who develops the computer model, or markets the computer model or investment advice program, utilized in satisfaction of paragraph (b)(4) of this section.

(3) A “registered representative” of another entity means a person described in section 3(a)(18) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(18)) (substituting the entity for the broker or dealer referred to in such section) or a person described in section 202(a)(17) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(17)) (substituting the entity for the investment adviser referred to in such section).

(4) “Individual Retirement Account” or “IRA” means—

(i) An individual retirement account described in section 408(a) of the Code;

(ii) An individual retirement annuity described in section 408(b) of the Code;

(iii) An Archer MSA described in section 220(d) of the Code;

(iv) A health savings account described in section 223(d) of the Code;

(v) A Coverdell education savings account described in section 530 of the Code; or

(vi) A trust, plan, account, or annuity which, at any time, has been determined by the Secretary of the Treasury to be described in any of paragraphs (c)(4)(i) through (v) of this section.

(5) An “affiliate” of another person means—

(i) Any person directly or indirectly owning, controlling, or holding with power to vote, 5 percent or more of the outstanding voting securities of such other person;

(ii) Any person 5 percent or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person;

(iii) Any person directly or indirectly controlling, controlled by, or under common control with, such other person; and

(iv) Any officer, director, partner, copartner, or employee of such other person.

(6)(i) A person with a “material affiliation” with another person means—

(A) Any affiliate of the other person;

(B) Any person directly or indirectly owning, controlling, or holding, 5 percent or more of the interests of such other person; and

(C) Any person 5 percent or more of whose interests are directly or indirectly owned, controlled, or held, by such other person.

(ii) For purposes of paragraph (c)(6)(i) of this section, “interest” means with respect to an entity—

(A) The combined voting power of all classes of stock entitled to vote or the total value of the shares of all classes of stock of the entity if the entity is a corporation;

(B) The capital interest or the profits interest of the entity if the entity is a partnership; or

(C) The beneficial interest of the entity if the entity is a trust or unincorporated enterprise.

(7) Persons have a “material contractual relationship” if payments made by one person to the other person pursuant to contracts or agreements between the persons exceed 10 percent of the gross revenue, on an annual basis, of such other person.

(8) “Control” means the power to exercise a controlling influence over the management or policies of a person other than an individual.

(d) *Class exemption*—(1) *General*. Pursuant to section 408(a) of the Act and section 4975(c)(2) of the Code—

(i) The restrictions of sections 406(a) and 406(b) of the Act and the sanctions resulting from the application of section 4975 of the Code, by reason of section 4975(c)(1)(A) through (F) of the Code, shall not apply to:

(A) The provision of investment advice described in section 3(21)(A)(ii) of the Act by a fiduciary adviser to a participant or beneficiary of an individual account plan that permits such participant or beneficiary to direct the investment of their individual accounts;

(B) The acquisition, holding, or sale of a security or other property pursuant to the investment advice; and

(C) except as otherwise provided in this exemption, the direct or indirect receipt of fees or other compensation by the fiduciary adviser (or any employee, agent, registered representative or affiliate thereof) in connection with the provision of the advice or in connection with an acquisition, holding, or sale of a security or other property pursuant to the investment advice, provided that the conditions set forth in paragraph (d)(2) are met;

(ii) The sanctions resulting from the application of section 4975 of the Code, by reason of section 4975(c)(1)(A) through (F) of the Code, shall not apply to:

(A) The provision of investment advice described in section 4975(e)(3)(B) of the Code by a fiduciary adviser to a beneficiary of an IRA that permits such beneficiary to direct the investment of the assets of his or her IRA;

(B) The acquisition, holding, or sale of a security or other property pursuant to the investment advice; and

(C) Except as otherwise provided in this exemption, the direct or indirect receipt of fees or other compensation by the fiduciary adviser (or any employee, agent, registered representative or affiliate thereof) in connection with the provision of the advice or in connection with an acquisition, holding, or sale of a security or other property pursuant to the investment advice, provided that the conditions set forth in paragraph (d)(2) of this section are met.

(2) *Conditions.* The relief described in paragraph (d)(1) shall be available if the fiduciary adviser—

(i) Provides investment advice in accordance with paragraphs (d)(3) or (4), or both; and

(ii) Satisfies the requirements of paragraphs (d)(5) through (10).

(3) *Use of computer model or investment education.* The requirements of this paragraph (d)(3) will be satisfied if:

(i) Except as provided in paragraph (d)(3)(ii), before providing other investment advice covered by this exemption, the participant or beneficiary shall be furnished with investment recommendations generated by a computer model that—

(A) Meets the requirements of paragraphs (b)(4)(i) and (ii); or

(B) Meets the requirements of paragraph (b)(4)(i) and was designed and is maintained by a person independent of the fiduciary adviser (and any of the adviser's affiliates) and utilizes methodologies and parameters determined appropriate solely by the independent person, without influence from the fiduciary adviser (or any of the adviser's affiliates); for purposes of this paragraph (d)(3)(i), a person is "independent" of another person if it is not an affiliate of the other person, and does not have a material affiliation or material contractual relationship with the other person.

(ii)(A) In the case of a plan that offers a "brokerage window," "self-directed brokerage account" or similar arrangement that enables participants and beneficiaries to select investments beyond those designated by the plan, if any, before providing investment advice with respect to any investment utilizing such arrangement, the participant or beneficiary shall be furnished the material described in paragraph (d)(3)(ii)(B) and, if the plan offers designated investment options, the participant or beneficiary also shall be furnished the recommendations described in paragraph (d)(3)(i) with regard to such options.

(B) In the case of an IRA with respect to which the types or number of investment choices reasonably precludes the use of a computer model meeting the requirements of section 408(g)(3)(B) of ERISA to generate recommendations, before providing other investment advice covered by this exemption, the participant or beneficiary shall be furnished with material, such as graphs, pie charts, case studies, worksheets, or interactive software or similar programs, that reflect or produce asset allocation models taking into account the age (or time horizon) and risk profile of the beneficiary, to the extent known. Nothing shall preclude the furnishing of material, in addition to the foregoing, reflecting asset allocation portfolios of hypothetical individuals with different time horizons and risk profiles. For purposes of any materials provided pursuant to this paragraph (d)(3)(ii):

(I) Models must be based on generally accepted investment theories that take

into account the historic returns of different asset classes (e.g., equities, bonds, or cash) over defined periods of time;

(2) Such models must operate in a manner that is not biased in favor of investments offered by the fiduciary adviser or a person with a material affiliation or material contractual relationship with the fiduciary adviser; and

(3) All material facts and assumptions on which such models are based (e.g., retirement ages, life expectancies, income levels, financial resources, replacement income ratios, inflation rates, and rates of return) accompany the models.

(iii) The fiduciary adviser shall retain the information furnished pursuant to paragraph (d)(3)(i) or (ii) in accordance with paragraph (e) of this section.

(4) *Use of fee-leveling.* Any fees or other compensation (including salary, bonuses, awards, promotions, commissions or any other thing of value) received, directly or indirectly, by an employee, agent or registered representative providing advice on behalf of the fiduciary adviser pursuant to this exemption (as distinguished from any compensation received by the fiduciary adviser on whose behalf the employee, agent or registered representative is providing such advice) do not vary depending on the basis of any investment option selected by a participant or beneficiary.

(5) *Authorized by a plan fiduciary or IRA beneficiary.* (i) Except as provided in paragraph (d)(5)(ii), the arrangement pursuant to which investment advice is provided to participants and beneficiaries is expressly authorized in advance by a plan fiduciary (or, in the case of an IRA, the IRA beneficiary) other than: The person offering the investment advice arrangement; any person providing designated investment options under the plan; or any affiliate of either. Provided, however, that for purposes of the preceding, in the case of an IRA, an IRA beneficiary will not be treated as an affiliate of a person solely by reason of being an employee of such person.

(ii) In the case of an arrangement pursuant to which investment advice is provided to participants and bene-

ficiaries of a plan sponsored by the person offering the arrangement or a plan sponsored by an affiliate of such person, the authorization described in paragraph (d)(5)(i) may be provided by the plan sponsor of such plan, provided that the person or affiliate offers the same arrangement to participants and beneficiaries of unaffiliated plans in the ordinary course of its business.

(iii) For purposes of the authorization described in paragraph (d)(5)(i), a plan sponsor shall not be treated as a person providing a designated investment option under the plan merely because one of the designated investment options of the plan is an option that permits investment in securities of the plan sponsor or an affiliate.

(6) *Basis for advice.* (i) The investment advice—

(A) Is based on generally accepted investment theories that take into account the historic returns of different asset classes over defined periods of time; provided, however, that nothing herein shall preclude any investment advice from being based on generally accepted investment theories that take into account additional considerations;

(B) Takes into account investment management and other fees and expenses attendant to the recommended investments; and

(C) Takes into account, to the extent furnished by a plan, participant or beneficiary, information relating to age, time horizons (e.g., life expectancy, retirement age), risk tolerance, current investments in designated investment options, other assets or sources of income, and investment preferences of the participant or beneficiary. A fiduciary adviser shall request such information, but nothing in this paragraph (d)(6)(i)(C) shall require that any investment advice take into account information requested, but not furnished by a participant or beneficiary, nor preclude requesting and taking into account additional information that a plan or participant or beneficiary may provide.

(ii) In connection with the provision of the investment advice—

(A) The fiduciary adviser concludes that the advice to be provided is prudent and in the best interest of the participant or beneficiary, and explains to the participant or beneficiary—

(1) The basis for the conclusion,

(2) If applicable, why the advice includes an option(s) with higher fees than other options in the same asset class(es) available under the plan, and

(3) If applicable, in the case of investment advice provided pursuant to paragraph (d)(3)(i) or (ii), how the advice deviates from or relates to the information provided pursuant to such paragraphs;

(B) Not later than 30 days following the explanation described in paragraph (d)(6)(ii)(A), the employee, agent, or registered representative providing the advice on behalf of the fiduciary adviser shall document such explanation; and

(C) The fiduciary adviser retains the documentation developed pursuant to paragraph (d)(6)(ii)(B) in accordance with paragraph (e) of this section.

(7) *Policies and procedures.* The fiduciary adviser adopts and follows written policies and procedures that are designed to assure compliance with the conditions of this exemption.

(8) *Disclosure.* (i) The fiduciary adviser provides, without charge, to the participant or beneficiary before the initial provision of investment advice under the class exemption, written notification of:

(A) The role of any party that has a material affiliation or material contractual relationship with the fiduciary adviser in the development of the computer model described in paragraph (d)(3)(i) of this section or, if applicable, the materials described in paragraph (d)(3)(ii) of this section, and, to the extent applicable, in the selection of investment options available under the plan;

(B) The types of services provided by the fiduciary adviser in connection with the provision of investment advice by the fiduciary adviser, including, with respect to a computer model arrangement referred to in paragraph (d)(3)(i) of this section, any limitations on the ability of a computer model to take into account an investment pri-

marily in qualifying employer securities; and

(C) The information described in paragraphs (b)(7)(i)(B) through (E), (G) and (H);

(ii)(A) Such notification must be written in a clear and conspicuous manner and in a manner calculated to be understood by the average plan participant and shall be sufficiently accurate and comprehensive to reasonably apprise such participants and beneficiaries of the information required to be disclosed;

(B) The appendix to this section contains a model disclosure form that may be used to provide the notification of information described in paragraph (b)(7)(i)(C). Use of the model disclosure form is not mandatory. However, use of an appropriately completed model disclosure form will be deemed to satisfy the requirements of paragraphs (d)(8)(i)(C) and (d)(8)(ii)(A) with respect to such information.

(iii) Such notification may, in accordance with 29 CFR 2520.104b-1, be provided in written or electronic form.

(iv) With respect to the information required to be disclosed pursuant to paragraph (d)(8)(i) of this section, the fiduciary adviser shall, at all times during the provision of advisory services to the participant or beneficiary pursuant to the arrangement—

(A) Maintain accurate, up-to-date information in a form that is consistent with paragraph (d)(8)(ii) of this section,

(B) Provide, without charge, accurate, up-to-date information to the recipient of the advice no less frequently than annually,

(C) Provide, without charge, accurate information to the recipient of the advice upon request of the recipient, and

(D) Provide, without charge, to the recipient of the advice any material change to the information described in paragraph (d)(8)(i) at a time reasonably contemporaneous to the change in information.

(9) *Annual audit.* (i) The fiduciary adviser shall, at least annually, engage an independent auditor, who has appropriate technical training or experience and proficiency and so represents in writing to the fiduciary adviser, to:

(A) Conduct an audit for compliance with the policies and procedures of

paragraph (d)(7) of this section and the requirements of paragraph (d) of this section; and

(B) Within 60 days following the completion of the audit, issue a written report to the fiduciary adviser, and, except with respect to an arrangement with an IRA, to each fiduciary who authorized the arrangement, in accordance with paragraph (d)(5), setting forth the specific findings of the auditor regarding compliance of the arrangement with the policies and procedures of paragraph (d)(7) and the requirements of paragraph (d) of this section.

(ii) With respect to an arrangement with an IRA, the fiduciary adviser:

(A) Within 30 days following receipt of the report from the auditor, shall furnish a copy of the report to the IRA beneficiary or make such report available on its Web site, provided that such beneficiaries are provided information, with the information required to be disclosed pursuant to paragraph (d)(8) of this section, concerning the purpose of the report, and how and where to locate the report applicable to their account; and

(B) In the event that the report of the auditor identifies noncompliance with the policies and procedures required by paragraph (d)(7) or the conditions of paragraph (d) of this section, within 30 days following receipt of the report from the auditor, sends a copy of the report to the Department of Labor at the following address: Investment Advice Notification—Class Exemption, U.S. Department of Labor, Employee Benefits Security Administration, Room N-1513, 200 Constitution Ave., NW., Washington, DC 20210.

(iii) For purposes of paragraph (d)(9)(i), an auditor is considered independent if it does not have a material affiliation or material contractual relationship with the person offering the investment advice arrangement to the plan or IRA or any designated investment options under the plan or IRA.

(iv) For purposes of the audit described in paragraph (d)(9)(i), the auditor shall review sufficient relevant information to formulate an opinion as to whether the investment advice arrangements, and the advice provided pursuant thereto, offered by the fiduciary adviser during the audit period

were in compliance with the policies and procedures of paragraph (d)(7) of this section and the requirements of this paragraph (d); provided, however, that nothing in this subparagraph shall preclude an auditor from using information obtained by sampling, as reasonably determined appropriate by the auditor, investment advice arrangements, and the advice pursuant thereto, during the audit period.

(v) The selection of an auditor for purposes of this paragraph (d)(9) is a fiduciary act governed by section 404(a)(1) of ERISA.

(10) *Other.* The requirements of paragraph (b)(8), relating to other conditions, and paragraph (e), relating to retention of records, of this section are met.

(e) *Retention of records.* The fiduciary adviser must maintain, for a period of not less than 6 years after the provision of investment advice under this section any records necessary for determining whether the applicable requirements of this section have been met. A transaction prohibited under section 406 of ERISA shall not be considered to have occurred solely because the records are lost or destroyed prior to the end of the 6-year period due to circumstances beyond the control of the fiduciary adviser.

(f) *Noncompliance.* (1) The relief from the prohibited transaction provisions of section 406 of ERISA and the sanctions resulting from the application of section 4975 of the Code described in paragraphs (b) and (d) of this section shall not apply to any transaction described in such paragraphs in connection with the provision of investment advice to an individual participant or beneficiary with respect to which the applicable conditions of this section have not been satisfied.

(2) In the case of a pattern or practice of noncompliance with any of the applicable conditions of this section, the relief described in paragraph (b) or (d) shall not apply to any transaction in connection with the provision of investment advice provided by the fiduciary adviser during the period over which the pattern or practice extended.

(g) *Applicability date.* This section shall apply to transactions described in

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paragraphs (b) and (d) of this section occurring on or after November 18, 2009.

APPENDIX TO § 2550.408G-1

FIDUCIARY ADVISER DISCLOSURE

This document contains important information about [enter name of Fiduciary Adviser] and how it is compensated for the investment advice provided to you. You should carefully consider this information in your evaluation of that advice.

[enter name of Fiduciary Adviser] has been selected to provide investment advisory services for the [enter name of Plan]. [enter name of Fiduciary Adviser] will be providing these services as a fiduciary under the Employee Retirement Income Security Act (ERISA). [enter name of Fiduciary Adviser], therefore, must act prudently and with only your interest in mind when providing you recommendations on how to invest your retirement assets.

COMPENSATION OF THE FIDUCIARY ADVISER AND RELATED PARTIES

[enter name of Fiduciary Adviser] (is/is not) compensated by the plan for the advice it provides. (if compensated by the plan, explain what and how compensation is charged (e.g., asset-based fee, flat fee, per advice)). (If applicable, [enter name of Fiduciary Adviser] is not compensated on the basis of the investment(s) selected by you.)

Affiliates of [enter name of Fiduciary Adviser] (if applicable enter, and other parties with whom [enter name of Fiduciary Adviser] is related or has a material financial relationship) also will be providing services for which they will be compensated. These services include: [enter description of services, e.g., investment management, transfer agent, custodial, and shareholder services for some/all the investment funds available under the plan.]

When [enter name of Fiduciary Adviser] recommends that you invest your assets in an investment fund of its own or one of its affiliates and you follow that advice, [enter name of Fiduciary Adviser] or that affiliate will receive compensation from the investment fund based on the amount you invest. The amounts that will be paid by you will vary depending on the particular fund in which you invest your assets and may range from ___% to ___%. Specific information concerning the fees and other charges of each investment fund is available from [enter source, such as: your plan administrator, investment fund provider (possibly with Internet Web site address)]. This information should be reviewed carefully before you make an investment decision.

(if applicable enter, [enter name of Fiduciary Adviser] or affiliates of [enter name of

Fiduciary Adviser] also receive compensation from non-affiliated investment funds as a result investments you make as a result of recommendations of [enter name of Fiduciary Adviser]. The amount of this compensation also may vary depending on the particular fund in which you invest. This compensation may range from ___% to ___%. Specific information concerning the fees and other charges of each investment fund is available from [enter source, such as: your plan administrator, investment fund provider (possibly with Internet Web site address)]. This information should be reviewed carefully before you make an investment decision.

(if applicable enter, In addition to the above, [enter name of Fiduciary Adviser] or affiliates of [enter name of Fiduciary Adviser] also receive other fees or compensation, such as commissions, in connection with the sale, acquisition or holding of investments selected by you as a result of recommendations of [enter name of Fiduciary Adviser]. These amounts are: [enter description of all other fees or compensation to be received in connection with sale, acquisition or holding of investments]. This information should be reviewed carefully before you make an investment decision.

(if applicable enter, When [enter name of Fiduciary Adviser] recommends that you take a rollover or other distribution of assets from the plan, or recommends how those assets should subsequently be invested, [enter name of Fiduciary Adviser] or affiliates of [enter name of Fiduciary Adviser] will receive additional fees or compensation. These amounts are: [enter description of all other fees or compensation to be received in connection with any rollover or other distribution of plan assets or the investment of distributed assets]. This information should be reviewed carefully before you make a decision to take a distribution.

CONSIDER IMPACT OF COMPENSATION ON ADVICE

The fees and other compensation that [enter name of Fiduciary Adviser] and its affiliates receive on account of assets in [enter name of Fiduciary Adviser] (enter if applicable, and non-[enter name of Fiduciary Adviser]) investment funds are a significant source of revenue for the [enter name of Fiduciary Adviser] and its affiliates. You should carefully consider the impact of any such fees and compensation in your evaluation of the investment advice that [enter name of Fiduciary Adviser] provides to you. In this regard, you may arrange for the provision of advice by another adviser that may have not material affiliation with or receive compensation in connection with the investment funds or products offered under the

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plan. This type of advice is/is not available through your plan.

INVESTMENT RETURNS

While understanding investment-related fees and expenses is important in making informed investment decisions, it is also important to consider additional information about your investment options, such as performance, investment strategies and risks. Specific information related to the past performance and historical rates of return of the investment options available under the plan (has/has not) been provided to you by [enter source, such as: your plan administrator, investment fund provider]. (If applicable enter. If not provided to you, the information is attached to this document.)

For options with returns that vary over time, past performance does not guarantee how your investment in the option will perform in the future; your investment in these options could lose money.

PARTIES PARTICIPATING IN DEVELOPMENT OF ADVICE PROGRAM OR SELECTION OF INVESTMENT OPTIONS

Name, and describe role of, affiliates or other parties with whom the fiduciary adviser has a material affiliation or contractual relationship that participated in the development of the investment advice program (if this is an arrangement that uses computer models) or the selection of investment options available under the plan.

USE OF PERSONAL INFORMATION

Include a brief explanation of the following—

What personal information will be collected;

How the information will be used;

Parties with whom information will be shared;

How the information will be protected; and

When and how notice of the Fiduciary Adviser's privacy statement will be available to participants and beneficiaries.

Should you have any questions about [enter name of Fiduciary Adviser] or the information contained in this document, you may contact [enter name of contact person for fiduciary adviser, telephone number, address].

[74 FR 3846, Jan. 21, 2009, as amended at 74 FR 11848, Mar. 20, 2009; 74 FR 23952, May 22, 2009]

EFFECTIVE DATE NOTE: At 74 FR 3846, Jan. 21, 2009, §2550.408g-1 was added, effective Mar. 23, 2009. At 74 FR 11847, Mar. 20, 2009, the effective and applicability date of the Jan. 21, 2009 rule was delayed until May 22, 2009. At 74 FR 23951, May 22, 2009, the effective date was further delayed until Nov. 18, 2009. At 74 FR 11848, Mar. 20, 2009, paragraph

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(g) was amended by removing the date "March 23, 2009" and adding in its place "May 22, 2009." At 74 FR 23952, May 22, 2009, paragraph (g) was amended by removing the date "May 22, 2009" and adding in its place "November 18, 2009."

§ 2550.408g-2 Investment advice—fiduciary election.

(a) *General.* Section 408(g)(11)(A) of the Employee Retirement Income Security Act, as amended (ERISA), provides that a person who develops a computer model or who markets a computer model or investment advice program used in an "eligible investment advice arrangement" shall be treated as a fiduciary of a plan by reason of the provision of investment advice referred to in ERISA section 3(21)(A)(ii) to the plan participant or beneficiary, and shall be treated as a "fiduciary adviser" for purposes of ERISA sections 408(b)(14) and 408(g), except that the Secretary of Labor may prescribe rules under which only one fiduciary adviser may elect to be treated as a fiduciary with respect to the plan. Section 4975(f)(8)(J)(i) of the Internal Revenue Code, as amended (the Code), contains a parallel provision to ERISA section 408(g)(11)(A) that applies for purposes of Code sections 4975(d)(17) and 4975(f)(8). This section sets forth requirements that must be satisfied in order for one such fiduciary adviser to elect to be treated as a fiduciary with respect to a plan under an eligible investment advice arrangement.

(b)(1) If an election meets the requirements in paragraph (b)(2) of this section, then the person identified in the election shall be the sole fiduciary adviser treated as a fiduciary by reason of developing or marketing the computer model, or marketing the investment advice program, used in an eligible investment advice arrangement.

(2) An election satisfies the requirements of this subparagraph with respect to an eligible investment advice arrangement if the election is in writing and such writing—

(i) Identifies the investment advice arrangement, and the person offering the arrangement, with respect to which the election is to be effective;

(ii) Identifies a person who—

(A) Is described in any of 29 CFR 2550.408g-1(c)(2)(i)(A) through (E);

(B) Develops the computer model, or markets the computer model or investment advice program, utilized in satisfaction of 29 CFR 2550.408g-1(b)(4) with respect to the arrangement, and

(C) Acknowledges that it elects to be treated as the only fiduciary, and fiduciary adviser, by reason of developing such computer model, or marketing such computer model or investment advice program;

(iii) Is signed by the person identified in paragraph (b)(2)(ii) of this section;

(iv) Is furnished to the fiduciary who authorized the arrangement, in accordance with 29 CFR 2550.408g-1(b)(5); and

(v) Is maintained in accordance with 29 CFR 2550.408g-1(e).

[74 FR 3853, Jan. 21, 2009, as amended at 74 FR 11847, Mar. 20, 2009; 74 FR 23951, May 22, 2009]

EFFECTIVE DATE NOTE: At 74 FR 3853, Jan. 21, 2009, §2550.408g-2 was added, effective Mar. 23, 2009. At 74 FR 11847, Mar. 20, 2009, the effective date was delayed until May 22, 2009. . At 74 FR 23951, May 22, 2009, the effective date was delayed until Nov. 18, 2009

§2550.412-1 Temporary bonding requirements.

(a) Pending the issuance of permanent regulations with respect to the bonding provisions under section 412 of the Employee Retirement Income Security Act of 1974 (the Act), any plan official, as defined in section 412(a) of the Act, shall be deemed to be in compliance with the bonding requirements of the Act if he or she is bonded under a bond which would have been in compliance with section 13 of the Welfare and Pension Plans Disclosure Act, as amended (the WPPDA), and with the basic bonding requirements of subparts A through E of part 2580, title 29 CFR, and with the prohibition against bonding by parties interested in the plan contained in subpart G of part 2580 of such title, or would be exempt from such bonding requirements because bonding would not be required under the exemption provisions contained in subpart F of part 2580 of such title. Part 2580 of this title incorporates material previously designated as subparts A through E of part 464, subpart B of part 465 and part 485 of this title of the CFR. The requirements which are set forth in the temporary regula-

tions hereby adopted shall be applicable to all employee benefit plans covered by the Act, including those plans which were not covered by the WPPDA. Thus, for example, the regulations so adopted are applicable to plans containing fewer than 26 participants, although such plans were not covered by the WPPDA.

(b) For the purpose of this temporary regulation, any bond or rider thereto obtained by a plan official which contains a reference to the WPPDA will be construed by the Secretary to refer to the Act: *Provided*, That the surety company so agrees.

(c) For the purpose of this regulation,

(1) Any reference to section 13 of the WPPDA or any subsection thereof in the regulations issued under the WPPDA and which are incorporated by reference by this temporary regulation shall be deemed to refer to section 412 of the Act, or the corresponding subsection thereof,

(2) Where the particular phrases set forth in the Act are not identical to the phrases in the WPPDA and the regulations issued pursuant thereto, the phrases appearing in the Act shall be substituted by operation of law, and

(3) Where the phrases are identical but the meaning is different, the meaning given such phrases by the Act shall govern. For example, the phrase “administrators, officers, and employees of any employee welfare benefit plan or of any employee pension benefit plan subject to this Act who handle funds or other property of such plan” which appears in section 13 of the WPPDA and the regulations issued thereunder shall be construed to mean, for purposes of this regulation, “plan officials”, which is the term appearing in section 412 of the Act, and the terms “employee welfare benefit plan” and “employee pension benefit plan” shall be given the meaning assigned to them by the Act, and not the meaning set forth in the WPPDA.

(d) The requirements of this temporary regulation, as set forth in paragraphs (a) through (c) of this section, shall remain in effect pending the

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issuance of permanent regulations by the Secretary.

[40 FR 2203, Jan. 10, 1975. Redesignated at 40 FR 20629, May 12, 1975, as amended at 50 FR 26706, June 28, 1985]