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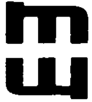

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David J. Witz
Fiduciary Risk Assessment LLC
5644 Rocky Trail Court
Charlotte, North Carolina 28270

Re: 404c "MASTER" Diagnostic

Dear David:

Fiduciary Risk Assessment LLC ("FRA") asked our firm to review and evaluate the 404c "MASTER" Diagnostic (the "Program"). Under this engagement, we have reviewed the questions and answers that provide the basis for the Program, as well as the supplemental materials that the Program provides its users. We understand that the Program will be offered to plan sponsors of retirement benefit plans (as described below) to assist in fulfilling a key part of their fiduciary responsibility to the employees who participate in the sponsors' plans.

The Employee Retirement Income Security Act of 1974 ("ERISA") is the primary source for the regulation of employer-provided benefit plans in the United States ERISA was intended to provide a comprehensive framework by which the rights and obligations of employers and employees may be understood and enforced, both for retirement and (to a lesser extent) welfare benefits. The U.S. Department of Labor (the "DOL") administers the applicable provisions of this federal law and has responsibility for issuing regulations interpreting ERISA.

One of the cornerstones of plans that are subject to ERISA is concept of a "fiduciary". ERISA regulates the fiduciaries of employer-sponsored plans, requiring them to protect the interests of plan participants and their beneficiaries. To assist fiduciaries in fulfilling these responsibilities, the statute provides fiduciaries with guidelines to help them to ensure that they are discharging their duties in accordance with ERISA, the regulations issued thereunder, and the terms of the plan.

For purposes of this letter, we have addressed only the concerns of tax-qualified "employee pension benefit plans", as such term is defined in ERISA Section 3(2). However, this letter does not address terms and operations of a plan that may affect its tax-qualified status; rather, our review has been limited to the interaction of the Program with the fiduciary responsibilities of employers that sponsor an "individual account plan" (as defined in ERISA Section 3(34)) that is qualified under Internal Revenue Code sections 401(a) and 401(k). In this letter, such a plan is described as a "401(k) plan".

ERISA imposes several duties on the fiduciaries of a 401(k) plan, several of which are germane to the Program and our evaluation. Typically under ERISA, the employer is the "plan sponsor" and the plan sponsor is a plan fiduciary. ERISA specifies four primary duties which a fiduciary may owe to a retirement plan.

The duty of loyalty requires a plan fiduciary to act "solely in the interest of the participants and beneficiaries." (ERISA Section 404(a)(1)(A))

The duties of care and prudence require a fiduciary to act with the care, skill, prudence and diligence, under the circumstances then prevailing, that a prudent person acting in a like capacity and familiar with such matters would use. (ERISA Section 404(a)(1)(B))

The third primary fiduciary duty is that of diversification, and it requires a fiduciary to diversify investments in a plan to minimize the risk of large losses (unless it is clearly prudent not to diversify). (ERISA Section 404(a)(1)(C))

The fourth primary fiduciary duty imposed by ERISA requires a fiduciary to act in accordance with the plan documents. (ERISA Section 404(a)(1)(D))

Today, many 401(k) plans are designed to be "participant-directed", under which employees who participate in the plan are offered a variety of investment options in which to direct the investment of their individual accounts in the 401(k) plan. By giving participants discretionary investment control over their accounts, the plan sponsor and the plan's other fiduciaries could become liable for participant selections that result in losses or, potentially, lower than expected gains, particularly where a participant fails to diversify the investments in the account as required by ERISA Section 404(a)(1)(C).

In order to protect the plan sponsor and the plan's other fiduciaries, ERISA Section 404(c) provides that, for purposes of the fiduciary duty relating to diversification, a fiduciary will not be deemed to be a fiduciary to the extent that plan participants allocate their account balances among investment alternatives in accordance with regulations issued by the Secretary of Labor. In 1992, the DOL issued regulations under ERISA Section 404(c) that provide rules for fiduciary relief in this area. These regulations provide critical guidance for plan sponsors seeking to avoid investment responsibility to the extent possible under ERISA, by describing in detail how an employer may shift to participants the responsibility to allocate assets in the participant's individual account from within an employer-selected group of investments. A plan sponsor who fully complies with the ERISA Section 404(c) regulations has an affirmative defense against claims of fiduciary breach in the participant's asset allocation decisions.

Although a recent U.S. Court of Appeals decision suggests that compliance with ERISA Section 404(c) is not the exclusive method of avoiding fiduciary liability in a participant-directed plan,

full-compliance with ERISA 404(c) remains the only certain way of avoiding such fiduciary liability.[1] Furthermore, the DOL's recently-issued proposed regulations on default investments in participant-directed plans makes it clear that, although a fiduciary may be relieved of investment responsibility for selecting the default investment by complying with the proposed regulations, the DOL anticipates that plan sponsors seeking full relief in a participant-directed account would try to comply fully with ERISA Section 404(c) and the DOL regulations.

Under the highly-technical regulations, a fiduciary retains responsibility for a participant's investment direction unless such participant is permitted to exercise meaningful, independent control over the investments in his or her account. In order to provide such meaningful and effective control, the participant must be given the opportunity to:

1. select from a broad range of investment alternatives and diversify the investments within and among the alternatives;

2. give investment instructions (to the trustee or custodian) with a frequency which is appropriate in light of the volatility for the investment alternative; and

3. obtain sufficient information from the fiduciary or other party in order to make informed investment decisions.

The DOL has indicated (and the courts have agreed) that it is a fiduciary's burden to prove that the conditions of ERISA Section 404(c) (and the regulations thereunder) have been met. Failure to meet <u>all</u> of these requirements may result in the plan sponsor (or other designated 401(k) plan fiduciary) retaining - perhaps unwittingly- responsibility for a participant's investment decisions in the 401(k) plan.

The Program is designed to permit a 401(k) plan sponsor to identify and evaluate areas of non-compliance with ERISA Section 404(c). This is accomplished by requiring the plan sponsor to answer a series of yes-or-no questions covering the wide-range of ERISA Section 404(c) compliance. These questions compel the plan sponsor to closely review all of its practices and determine, based on the plan sponsor's answers to the questions, where additional attention may be needed. We note the thoroughness of the questions and the additional materials provided by the Program, which describe the regulatory structure which prompts each inquiry. The Program then uses the plan sponsor's answers to the questions as the basis of an extensive report with a suggested process to secure ERISA Section 404(c) fiduciary relief. The plan sponsor then is directed to review the report and its suggested course of action with its counsel.

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[1] In *Jenkins v. Yager*, 2006 WL 956944 (7th Cir. 2006), the Court of Appeals for the Seventh Circuit held that ERISA contains an implied exception to the general rule on investment responsibility, permitting a fiduciary to delegate investment decisions to participants without full compliance with ERISA Section 404(c)(C) and the regulations thereunder.

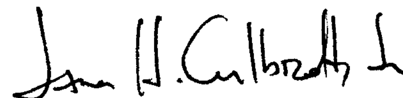
By completing the Program's questions and answers, reviewing the additional supporting material that the Program provides, and examining the contents of the final report, the sponsor of a 401(k) plan will be able to determine if the protections of ERISA Section 404(c) are available, or if the participant has not been provided enough information to satisfy the regulatory requirements, which could result in the plan sponsor retaining the fiduciary's risk of investment diversification.

The final report in the Program also produces a comparison of the 401(k) plan's administrative practices against those which are considered "best practices" for fiduciaries. The report created by the Program suggests a prudent monitoring process that will assist the plan sponsor in maintaining compliance. All of these benefits are based upon the assumption that the plan sponsor candidly answers all questions during the investigatory process.

Based on our firm's review of the Program, we have determined that the Program, if used properly, offers plan sponsors, their counsel, service providers and industry advisors a solution to identify, evaluate, monitor and mitigate fiduciary risk under ERISA Section 404(c). Additionally, by utilizing a customizable solution like the Program that can be adapted to the needs of any given plan, sponsor fiduciaries can create a documented ERISA Section 404(c) compliance process. Our experience is that a documented process is critical to the successful defense of the fiduciary relief claimed under ERISA Section 404(c), and the Program is intended to provide an efficient means of delivering and maintaining a documented "best practices" approach.

Assuming a sponsor of a 401(k) plan both accurately and completely answers all questions in the Program and consults thereafter with counsel or other advisors concerning the need to implement any changes to the administration of the 401(k) plan which are suggested by the Program, the report produced by the Program may be used to determine if the protection of ERISA Section 404(c) is available to the 401(k) plan's fiduciaries. We further believe that properly using the resources and reports provided by the Program will produce for fiduciaries a report and monitoring system that is consistent with the best practices currently in the industry.

Very truly yours,



James H. Culbreth, Jr.
For the Firm

JHC/pb