

Mutual Fund Abuses **Department of Labor Issues Guidance**

Mutual fund abuses have received a lot of publicity in recent months. Fund managers have been forced to resign and several lawsuits have been filed because of late trading and market-timing abuses. Retirement plan fiduciaries must assess the impact of these abuses on their plans' investments and investment options and determine whether or not changes should be made.

Department of Labor Guidance

The Department of Labor ("DOL") has issued guidance to plan fiduciaries in the form of a statement by Ann Combs, Assistant Secretary of the DOL's Employee Benefits Security Administration. The guidance suggests what fiduciaries should consider in determining actions they should take with respect to their plan's investments.

Funds Under Investigation

If funds in the plan have been identified as "under investigation" by Federal or state regulators, fiduciaries should review:

- ✓ the potential economic impact on the plan investments,
- ✓ the steps taken by the fund to limit the potential for such abuses in the future, and
- ✓ any remedial action taken or contemplated to make investors whole.

If any of this information has not been provided by the fund, a plan fiduciary should contact the fund directly to obtain specific information.

In light of this review, fiduciaries may need to determine if a particular fund should be dropped from the plan. Fiduciaries may also need to determine whether to participate in lawsuits or settlements, taking into account the potential cost to the plans versus the possible recovery.

IMPORTANT: Fiduciaries should document these specific decisions, including the basis upon which they were made.

Funds Not Under Investigation

In cases where funds have not been identified as "under investigation" by Federal or state regulators, fiduciaries nevertheless should review them to determine if the funds have procedures and safeguards in place to limit their vulnerability to abuse.

Market Timing Restrictions Within a Plan

The DOL guidance addresses whether restrictions designed to limit market-timing within a plan will affect the availability of protection under Section 404(c) of ERISA¹:

The guidance specifically addresses the following:

- ✓ mutual funds that impose a reasonable redemption fee on sales, and
- ✓ reasonable plan limits on the number of times a participant can trade in and out of a particular investment fund within a set period.

According to Assistant Secretary Combs, the DOL believes that these two approaches to market-timing restrictions, in and of themselves, do not negatively affect the availability of Section 404(c) protection, so long as:

- ✓ the plan, by its terms, allows such restrictions, and
- ✓ the restrictions are described clearly to participants and beneficiaries.

It is important to remember that in the case of any fiduciary decision, it is difficult to state hard and fast rules because every decision must be assessed in light of the particular facts and circumstances that apply. The examples of market-timing restrictions cited above must still be reviewed by fiduciaries in order to determine whether they are appropriate in the context of the specific circumstances pertaining to their plans.

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As a general rule, plan fiduciaries should make sure that they have established procedures relating to investment decisions, that these procedures are documented in an investment policy statement and that they are being followed. The guiding principle for fiduciaries should be to ensure that appropriate efforts are being made to act reasonably, prudently and solely in the interests of the plan's participants and beneficiaries. If you need assistance, please call your Kravitz consultant.

¹ ERISA Section 404(c) relieves fiduciaries of individual account plans, such as 401(k) plans, from liability for the results of investment decisions made by plan participants and beneficiaries. In order to qualify for this protection, plans must follow certain rules.

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