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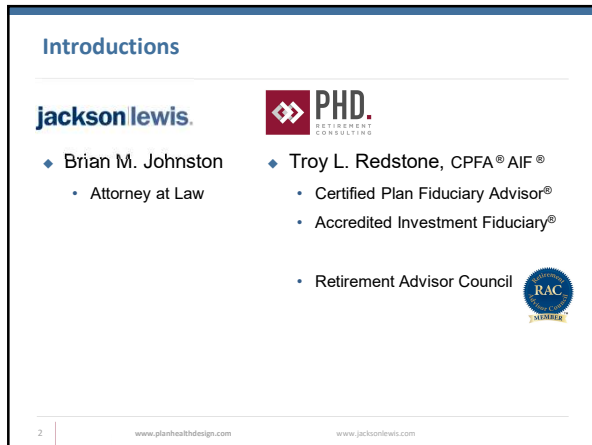
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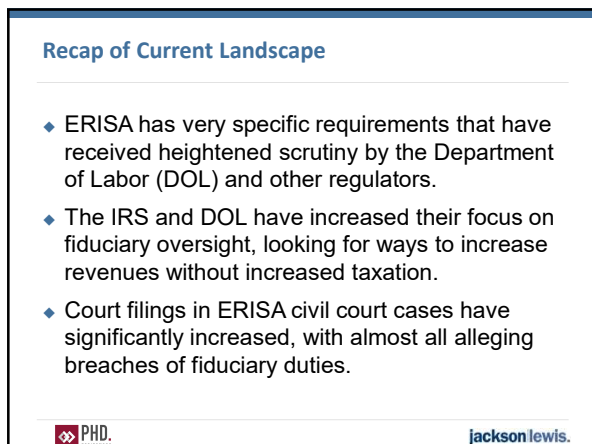
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### What Happens for Fiduciaries Who Don't Comply

- ◆ Under ERISA, a plan fiduciary that breaches his or her fiduciary duty to a plan can be (by the DOL or courts):
  - **Personally liable** to reimburse the plan for any losses;
  - Personally responsible for disgorging any profits that he or she made through the use of plan assets and restoring those profits to the plan; and/or
  - Removed from serving as a fiduciary.



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### Reminder: Who is a "Fiduciary"?

- ◆ Facts and circumstances control;
- ◆ A person is a "fiduciary" of an employee benefit plan to the extent that he or she:
  - Exercises any discretionary authority or control over the management or administration of the plan or the disposition of a plan's assets; OR
  - Provides **investment advice** to or on behalf of a plan for a fee or other compensation, direct or indirect, or has any authority or responsibility to do so.



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### Fiduciary Examples

- ◆ Plan Trustees;
- ◆ "Directed" Trustees;
- ◆ Plan Committee members;
- ◆ Board of Directors members (e.g., Enron);
- ◆ "Directed" investment advisors (e.g., "3(21) Advisors)
- ◆ "Discretionary" investment advisors (e.g., "3(38) Advisors);
- ◆ Other Investment managers;
- ◆ Officers appointed "de facto" over plan operations;
- ◆ Other service providers that have actual or effective discretion or control over the plan or its assets. **BUT general broker/agency relationship is NOT de facto fiduciary status**

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**Recap: As a Fiduciary, you must:**

- ◆ **Make decisions** that are in the **best interests of the Plan's participants**;
- ◆ **Choose appropriate investment options** (only requires prudent action);
- ◆ **Evaluate all costs** that impact investment options (including making a determination that all direct or indirect costs or compensation paid by the plan is "reasonable" under the circumstances);
- ◆ **Continually monitor the investment options** (not just for plan performance, but also potential mismanagement, e.g. Madoff-type schemes).

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**Key Focus Areas**

- I. Fees
- II. Investments
- III. Fiduciary Delegation
- IV. Legal Compliance

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**I. Fees: Legal Standards**

- ◆ **ERISA 404(a)(1)(A): Exclusive Purpose Rule**
  - Provide benefits to participants and beneficiaries
  - Defraying reasonable expense of administering the plan
    - Webster Definition: "Defray" = to provide for the payment of
      - i.e., Plans should only pay out of Plan assets, benefits that are required by the Plan and/or only those expenses that are "reasonable".
- ◆ **ERISA 408(b)(2):**
  - "Reasonable compensation" may be paid for necessary Plan services.
- ◆ **DOL Reg. Section 2550.404a-5:**
  - Requires disclosure on participant account statements of all fees charged against "covered individual account plans" (i.e., 401(k) and 403(b) plans, etc.).

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### I. Fees: Understanding the Cost

- ◆ Plan Administration Fees
  - Cost of basic administration, recordkeeping, accounting and trustee services
- ◆ Participant Transaction Fees
  - Optional services provided on an individual participant basis
- ◆ Advisory Fees
  - Investment advice to the plan participants or plan sponsor
- ◆ Investment Fees
  - Investment Management Fees – paid to investment managers
  - Sub-TA (Transfer Agent) Fees – paid to administrator or recordkeeper
  - 12b-1 Fees – marketing fee included in the fund's expense ratio, paid as commission to the plan advisor

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### I. Fees: Trend towards Zero Rev

- ◆ Investment Fees
  - Investment Management Fees (Expense Ratio) is most of the cost
- ◆ Is there Revenue Sharing to pay other plan expenses?
  - Admin / Recordkeeping / Advisor can be paid separately
    - Adding an asset-based fee
    - Adding a flat per head fee
- ◆ Pros & Cons of Asset-based Fee vs. Per head Fee
  - Full Disclosure
  - "Inequity" to small balance accounts that previously paid less?
  - How is this communicated to employees?
  - Will a hard-dollar cost on statements hurt participation?

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### I. Fees: Trends in Advisory Fees

**HISTORICALLY:** 12b-1 Commission Fees

**LESS DATED APPROACH:** Using an Asset-based Fee

**LATEST TREND:** Movement to Flat Fee

SOMETIMES PAID BY EMPLOYER, NOT PLAN

**Pros & Cons**

- Avoid conflicts of interest
- Assist with Plan Design

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**I. Fees: Know what you're paying**

- ◆ Doesn't have to be the cheapest
- ◆ But it should be FAIR, REASONABLE & NECESSARY
- ◆ And it should be known – fully disclosed
- ◆ Disclosures from EVERY Covered Service Provider (CSP)
  - A CSP can be a recordkeeper, administrator, or advisor
  - Anyone to whom you pay \$1,000 or more

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**I. Fees: Best Practices in Summary**

- ◆ There is no such thing as a "FREE" plan
- ◆ Pros and cons of zero rev or per head fees
- ◆ TREND WITH ADVISOR FEES:  
from commission to fee-based to flat-fee
- ◆ Fee disclosures from EVERY C.S.P.

**AND REMEMBER:** bundled services with limited fund families can appear advantageous on their face, but often contain inherent overpayments and internal conflicts of interest.

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**II. Investments**

- ◆ Legal Requirement: ERISA Section 404(a)(1)(A) thru (D)
  - Key Elements:
    - Prudence
    - "Reasonableness"
    - Participant Best Interests
    - Diversification
    - Pursuant to written plan document

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**II. Investments: The Race to Zero**

- ◆ The Trend from Commission to Fees to Flat Fees has generally meant **FEE Compression**
- ◆ No service provider works for free

Managed Accounts  
Cross-selling Insurance & Financial Services

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**II. Investments: Professional Management's Key**

- ◆ Self-directors consistently underperform professional management (3%-5% on average)
- ◆ Diversification is the key to long-term retirement planning
- ◆ Managed Accounts
  - a fee-based investment management product for high-net-worth individuals; the main appeal is access to professional managers with a high degree of customization
- ◆ Avoid the additional cost of Managed Accounts
  - GAO study on Managed Accounts (June, 2014)
    - <http://www.gao.gov/assets/670/664391.pdf>
  - There are cheaper (even FREE) means of professional management
  - The easiest and cheapest way to gain professional help with diversification is through an Age-based Target Date Fund

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**II. Investments: Professional Management's Key**

- ◆ Understanding the appropriate Target Date Funds
- ◆ The Department of Labor released Guidance in Feb, 2013
  - But most employers don't scrutinize TDFs enough
- ◆ A Glidepath Optimization Analysis
- ◆ Proprietary fund requirements
- ◆ Revenue sharing arrangements
- ◆ Avoid conflicts of interest



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### II. Investments: Professional Management's Key

- ◆ Avoid conflicts of interest
- ◆ **TREND:** Increase in auto-features ... the right plan default
  - The right default is to automatically enroll (an opt out)
  - The right default is to auto-diversify – professional management
  - BUT ...
    - The default investment had better be reasonably priced
    - It also can't just be the cash fund



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### II. Investments: "Low Cost" options

- ◆ Collective Investment Trusts – the growth of CITs
- ◆ **TREND:** Started with DCIO providers ... now more than 25%
  - CITs
    - Sponsored by banks & trust companies
    - Overseen by bank regulators and not SEC rules
- ◆ Increasingly popular in TDFs
- ◆ Also popular in Man. Accounts
- ◆ Not available in 403(b) plans



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### III. Fiduciary Delegation: Legal Standards

- ◆ **Legal Requirement under ERISA Section 409:**
  - Any person who is a fiduciary;
  - Who breaches his or her responsibilities, obligations or duties;
  - Is personally liable:
    - To "make good" any losses to the Plan; and
    - Restore to the Plan any profits of the fiduciary made through use of plan assets; and/or
    - Removal as a fiduciary;
    - Other penalties and "equitable relief"

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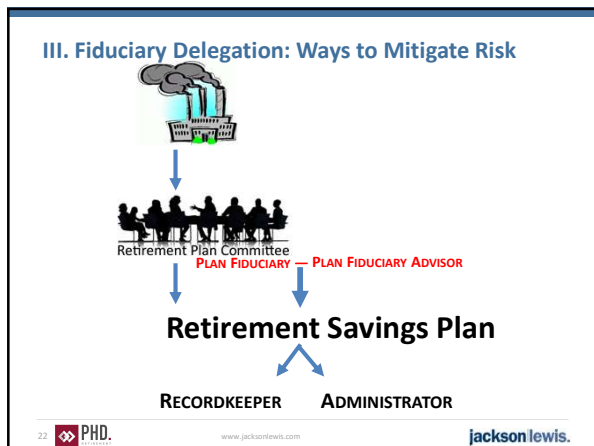
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### III. Fiduciary Delegation: Ways to Mitigate Risk

- ◆ Delegate Fiduciary Responsibility to a Committee

Retirement Plan Committee

- ◆ Not just an investment committee
- ◆ Keep executed copies of minutes and monitoring reports
- ◆ Regulators want to see evidence of Procedural Prudence

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### III. Fiduciary Delegation: Best Practices

Retirement Plan Committee

- ◆ There is no De Minimis Rule
- ◆ Quarterly review process
- ◆ Plan Fiduciary Advisor could help facilitate an agenda, keep minutes, and help to build and maintain the due diligence documentation process

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III. Fiduciary Delegation: Ways to Mitigate Risk

- ◆ **Delegate fiduciary responsibility to an investment manager:**
  - “ERISA 3(21) Fiduciary” – Monitor and make recommendations to Plan trustees;
  - “ERISA 3(38) Fiduciary” – Monitor investments and make all investment-related decisions and assume contractual liability.
  - “ERISA 402(a)(2)” – A “named fiduciary” in the plan document.
- ◆ Utilize **ERISA Section 404(c)** to delegate actual investment allocation decisions to each participant;
- ◆ **Purchase** fiduciary liability coverage.



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III. Fiduciary Delegation: Ways to Mitigate Risk

- ◆ **Note about “Co-Fiduciaries”**
- ◆ Even if fiduciary status is shared or delegated, an ERISA fiduciary can also be held liable for the breaches of other co-fiduciaries if he or she participates in or has knowledge of a breach (even a prior breach) by the other fiduciary and does not make a reasonable effort to remedy the breach.
- ◆ Still must be selected using prudent measures to ensure delegated fiduciaries are appropriately qualified, reasonably paid and undertaking their role as required under ERISA, and all actions must still be monitored;



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III. Fiduciary Delegation: Best Practices

- ◆ **Avoid conflicts of interest**
- ◆ **Try to avoid perceived conflicts of interest**
- ◆ **Avoid “parties in interest” or a “related party”**
- ◆ **Hiring your bank – a related entity**
- ◆ **Hiring a friend or relative – a related person.**  
The “brother-in-law” rule



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IV. Legal Compliance

- ◆ ERISA Section 404(a)(1)(D): Discharge duties in accordance with Plan document(s).
- ◆ Plan documents need to clearly set forth the terms and conditions of the Plan AND be updated to remain in compliance with applicable law (e.g., ERISA, Internal Revenue Code, etc.)
- ◆ Operational compliance with applicable law as well
  - Summary Plan Descriptions
  - Form 5500 filings
- ◆ Voluntary correction programs exist with DOL and IRS

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IV. Legal Compliance: Best Practices

- ◆ Audit your plans before the IRS or DOL does;
- ◆ Review your fiduciary appointment, authority or delegation process (if investment manager used);
- ◆ Examine plan committee procedures and documentation (e.g., meetings and minutes);
- ◆ Implement or modify investment management policies or processes (use an "IPS");
- ◆ IMMEDIATELY deposit participant contributions to the Plan and DO NOT use for any company purposes

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IV. Legal Compliance: Fiduciary Best Practices

- Determining "FAIR, REASONABLE and NECESSARY"
- ◆ Benchmark ALL plan costs including cost of the advisor
    - For investments – Is there a lower-cost share class?
    - For service providers – "reasonableness" standard
    - For the plan advisor – "reasonable & necessary" standard
  - ◆ It's not prudent to "just take your provider's word for it"
  - ◆ There are external, third-party reports available
    - "The 401k Averages Book" 18<sup>th</sup> Edition – Dave Huntley
    - Fee Benchmark<sup>®</sup> Advisor/Consultant Fee Comparison Report – Ann Schleck & Company

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### IV. Legal Compliance: Fiduciary Best Practices

#### Determining "FAIR, REASONABLE and NECESSARY"

- ◆ Requests For Proposal
- ◆ Full RFP, limited-scope RFP, "blind" RFP, RFI
- ◆ Third-party consultants can facilitate the RFP process
- ◆ Best Practice guidelines would be to conduct an RFP (to "go to market") every 3-5 years.
  - Not that a plan should move or change providers every 3-5 yrs
  - Benchmarking fees & services regularly is a fiduciary obligation
  - Retain the benchmark as documentation of a due diligence process

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### Summary

**PRUDENCE** **THE PRUDENT MAN RULE**  
 A Fiduciary should act with the care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would use in a similar situation.

*What would be prudent to do with your employee's money?*

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### Questions?

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