Managing Fiduciary Risk During a Down Market

A best-practices review and a strong partnership with your plan provider are essential in a turbulent economy.

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There is no better time for retirement plan fiduciaries to review their obligations than in the midst of an extended market downturn. During such times, fiduciaries may be at higher risk of ERISA lawsuits due to increased participant scrutiny and skepticism about their diligence. This is especially true in light of the extreme — and generally downward — market gyrations that began in 2008.

The recent past provides perspective

The recent past helps provide insight into the current landscape in which fiduciaries find themselves. Following the technology bust and accounting scandals earlier this decade, retirement-related lawsuits increased significantly.[1] Participants concerned about exposure to collapsed firms such as Enron and WorldCom took a greater interest in the actions and processes of the people they entrusted with their retirement savings. Today, the retirement plan industry faces a similar situation. Corporations once seen as rock-solid are sinking amid the unfolding global downturn — either due to risky financial practices or the culmination of long-term structural weaknesses. Discredited fund managers such as Bernard Madoff and Allen Stanford are making headlines.

In the midst of all this, participants are renewing their focus on plan fiduciaries. Simply put, when things go wrong, people often look for someone to blame. In this period of economic anxiety, when participants may face catastrophic shortfalls in their retirement accounts after decades of following prudent savings plans, suspected fiduciary negligence and subsequent lawsuits may become increasingly common. This is especially true for companies that fund retirement plans with their own stock.

In addition, following the Supreme Court's 2008 *LaRue* decision, the business media predicted "a raft of lawsuits by employees, *particularly as stock market volatility once again is causing havoc with investment accounts* [emphasis added]."[2] While *LaRue* did not increase fiduciary responsibilities, the decision "makes the fiduciary's attention to detail all the more important."[3] Fiduciaries

[1] "Lawyering Up: Insulating Your Company from a New Genre of Class Action Litigation," *PLANSPONSOR*, October 2004, www.plansponsor.com (accessed May 29, 2009).

[2] Carrie Johnson, "Supreme Court Rules Employees Can Sue Over 401(k) Misconduct" *Washington Post*, February 21, 2008, www.washingtonpost.com (accessed May 20, 2009).

[3] The Wright Group, *Retirement Report*, November 2008, www.thewrightgroupinc.com (accessed May 20, 2009).

should take note that simply consulting with and following the advice of a financial consultant does *not* constitute due diligence:

> Plan fiduciaries may not rely blindly on the investment advice they receive. Instead, they must review, evaluate and understand the advice… A plan fiduciary is not justified in relying wholly upon the advice of others, since it is the fiduciary's duty to exercise his own judgment in light of the information and advice received.[4]

Recommended best practices for managing fiduciary risk in a down market

Fiduciaries may be tempted to keep a low profile in hopes of riding out the market turbulence. However, in the event of an ERISA lawsuit, a court may not look kindly on this strategy:

> Plan fiduciaries must act quickly and prudently to deal with the market issues and to protect the plan assets. Prudence is largely a matter of process, and doing nothing is not an option. In assessing a plan fiduciary's prudence in a particular action, a court will examine the decision-making process and how the fiduciary went about reaching a decision, as opposed to the result of the decision.[5]

The following are recommended best practices for managing fiduciary risk in a down market:

1. Partner with a provider that offers a high level of fiduciary support.

Working in tandem with the plan advisor, a good provider will act as a true consultant and help keep fiduciaries educated as well as compliant. A good provider will also have the expertise and capability to actually help reduce a fiduciary's responsibilities. For example, as part of The Standard's investment advisory services, StanCorp Investment Advisers Inc., accepts fiduciary responsibility as defined by ERISA section 3(21) with respect to advising on the selection and monitoring of plan investments. In addition, we acknowledge this responsibility in writing.[6]

2. Follow a clear, written investment selection and monitoring process.

Defining the process

Fiduciary liability is not measured by investment performance, but by the process that guides the investment choices. Therefore, fiduciary due diligence is best achieved by having a clear, written process for making

[4] Jay P. Turner, "Mitigating Fiduciary Risk in a Down Market," *Workforce Management Online*, April 2009, www.workforce.com (accessed May 20, 2009).

[5] Jay P. Turner.

[6] Please ask for a sample investment advisory contract to review our clear written commitments.

investment decisions – and consistently following it. Investment decisions should be continually informed and well-reasoned. Plan fiduciaries should be proactive and take appropriate action when necessary.

Partnering with a provider and plan advisor that subscribe to a clear, documented process alleviates the pressure of uncertainty and sets benchmarks for fiduciary obligations. The Standard's investment and selection process is objectively defined, strictly enforced, and free of institutional bias. Our extensive process, based on both quantitative and qualitative criteria, includes comprehensive investment analysis and review, strict criteria across a broad range of investing styles to achieve market diversification[7] and specific criteria that lead to removal of poor-performing investments.

Creating an Investment Policy Statement (IPS)

An Investment Policy Statement (IPS) is a guide to help fiduciaries make investment decisions. It is not required by ERISA, but it is good protection for plan fiduciaries – and the absence of an IPS could work against them in certain circumstances. As a formal part of the investment selection and monitoring process, the importance of creating and maintaining an IPS cannot be overestimated and should be considered an essential tool for plan sponsors.

As a written investment strategy, an IPS is a documented commitment. The goals, objectives and constraints within become both a guide and a source of accountability for plan sponsors. An IPS can include the following: the plan's purpose; the plan's investment goals; intent to comply with ERISA Section 404(c); appropriate asset classes; the process for selecting, monitoring and terminating investment options; special provisions and restrictions; and participant communications, including information about investments.

Working in partnership with the plan advisor, The Standard can assist plan sponsors in developing an IPS (or provide them with a sample that can serve as an outline for developing one on their own). In addition, The Standard also helps plan sponsors adhere to their IPS.

3. Give participants access to appropriate and timely educational materials and resources.

During an economic downturn, participants need to be informed, reassured and kept abreast of market developments in order to retain their confidence in the management of their investments. Making timely and useful information available to plan participants is one measure of effective plan sponsorship. Maximize participant engagement by partnering with a provider that offers a complete library of varied communication materials. Newsletters, special articles, seminars, workshops, brochures, both print and web-based information, and more can play a key role in responsibly educating and informing participants.

[7] Diversification does not ensure a profit or protect against loss in a declining market.

The Standard maintains a comprehensive library of fiduciary and investment education materials, including tools for managing accounts during turbulent market conditions and ongoing participant education campaigns. During the recent market freefall, our outreach to participants included a series of educational flyers and articles that put retirement planning into perspective and offered strategies for investing in an unpredictable market[8].

4. Document everything.

Taking control of your fiduciary responsibilities starts with establishing an organized system to track your activities and actions. Amid the myriad of legal requirements mandated by ERISA, many fiduciaries are out of compliance and risking liability. A recent Grant Thornton survey found that only 58 percent of plan sponsors maintain minutes of retirement plan meetings, for example.[9]

Plan sponsors should document all participant enrollment meetings and ongoing educational campaigns, along with copies of any communications and educational content that were distributed to employees. Plan sponsors should also track all plan-related meetings, including the minutes of any investment committee or trustee meetings, and any decision made regarding investment selection or plan design. In short, any and all discussions and decisions related to the retirement plan should be well-documented and the information should be filed in a place that can be easily accessed.

The Standard provides plan sponsors with *Fiduciary Manager*, a top-to-bottom system for tracking and filing forms, agreements, correspondence, minutes and other due diligence documentation. Also included are checklists and sample communications that offer a framework for meeting obligations and monitoring tasks.

In addition, the kit includes a library of educational brochures and flyers that explain fiduciary responsibilities and describe compliance requirements. The Standard also offers its clients the Fiduciary Review, a comprehensive checklist of more than 100 items relating to fiduciary duties, responsibilities and best practices.

Planning for the future

The current market downturn provides an excellent opportunity for plan sponsors to refresh their understanding of fiduciary responsibilities and obligations. It also gives them an opportunity to make sure that they are partnered with a provider that can offer them the level of fiduciary support they truly need.

[8] "Retirement Planning in Turbulent Markets," The Standard.

[9] Robert Powell, "Who's Minding Your Retirement Plan?" MarketWatch, *The Wall Street Journal Digital Network*, March 26, 2009, www.marketwatch.com (accessed May 20, 2009).

During both good times and bad, plan sponsors should proactively offer participants relevant and timely ongoing education regarding how to best manage their retirement portfolios for the long term. Messages that relate to the importance of reallocation, the benefits of diversification and dollar-cost averaging[10] and how to manage different types of investment risk are all appropriate.

Maintaining clear, thorough records and having sound processes in place are the cornerstones of fiduciary risk management – especially during times of market volatility and economic turbulence. A fiduciary's meticulous record-keeping and clear communications provide reassurance that they are doing what is best and most appropriate for plan participants.

[10] Dollar-cost averaging does not ensure a profit or protect against a loss in declining markets.

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