Minimizing Fiduciary Risk

A Retirement Plan Sponsor's Guide

January 2015
The Standard

The purpose of this paper is to remind plan sponsors about the need for increased fiduciary awareness and suggest steps they can take to protect themselves, their board members, other fiduciaries and ultimately, their participants.

Employers face many challenges when sponsoring retirement plans, such as addressing the multitude of regulations and requirements. Plan sponsors failing to do so could face potential investigations and penalties.

The purpose of this paper is to remind plan sponsors about the need for increased fiduciary awareness and suggest steps they can take to protect themselves, their board members, other fiduciaries and ultimately, their participants.

Increased Demands On Fiduciaries

Under the Employee Retirement Income Security Act of 1974 (ERISA), every plan must have at least one fiduciary named in the plan document. The named fiduciary is the individual(s) or entity with authority to oversee the plan's operation and administration.

ERISA plans also come with greatly expanded responsibilities for fiduciaries to disclose plan fees. Fiduciaries also face heightened scrutiny on investment selection and cost to participants.

Fiduciaries are required to ensure the plan is being administered and maintained in the best interest of participants and according to the plan document and other pertinent plan documents such as the Investment Policy Statement.

A Focus On Fixing – And Auditing – Retirement Plans

Given the importance of plan sponsors' responsibilities, the Department of Labor (DOL) and IRS have increased their focus on audits and penalties. In fact, the DOL's audit staff now numbers more than 1,000.[1]

In November 2014, the IRS posted retirement plan Fix-It Guides on its website. Each of the five guides provides:

- An overview of the rules for each plan type
- An overview of the IRS' Employee Plans Compliance Resolution System
- The most frequent errors the IRS finds in each plan
- Tips on how to find, fix and avoid these mistakes[2]

1 "Warning: DOL found three-fourths of 401(k)s illegal," CFO Daily News, Feb. 25, 2014, www.cfodailynews.com/warning-dol-found-three-fourths-401ks-illegal (accessed Nov. 19, 2014)

2 "Fix-It Guides – Common Problems, Real Solutions," Internal Revenue Service, www.irs.gov/Retirement-Plans/Plan-Sponsor/Fix-It-Guides-Common-Problems-Real-Solutions (accessed Nov. 19, 2014; page last reviewed or updated: Nov. 4, 2014)

An article featured on Human Resource Executive® Online in April 2013 echoes what many in the industry believe, reporting: "...the Department of Labor plans to substantially increase the number of ERISA compliance audits it conducts each year, which may strike fear into the hearts of many HR professionals, particularly those responsible for this area."[3]

According to that article, the DOL conducts more than 3,000 audits each year, and one expert interviewed said that some type of plan failure is found in 70 percent of the audits. The article also notes, "While experts and advisors don't believe that companies or their staff members are deliberately doing things incorrectly, they do believe that significant opportunities for error – and audit – exist."[4]

"While experts and advisors don't believe that companies or their staff members are deliberately doing things incorrectly, they do believe that significant opportunities for error – and audit – exist."[4]

The Fiduciaries In Your Midst – From Plan Administrators To Board Members

Despite increased scrutiny and regulatory pressure on all sides, awareness of this issue among plan sponsors varies widely, depending on plan size and assets under management.

A January 2010 AllianceBernstein study of 1,000 plan sponsors, "Inside the Minds of Plan Sponsors," reported that 37 percent of survey respondents said "no" when asked if they considered themselves to be plan fiduciaries. "In other words, they know they're plan sponsors, but they may not realize they're plan fiduciaries." The study also reported, "Whether plan sponsors know they're fiduciaries or not, they're not particularly confident that all individuals serving in a fiduciary capacity are aware of their fiduciary status. Only a little more than half of respondents feel confident of that."[5]

Our experience working with plan sponsors has shown that uncertainty about fiduciary roles continues to be an issue. Under ERISA, any person who exercises decision-making authority over or discretionary control in the management of the plan or its assets is considered to be a fiduciary.

You can become a fiduciary in one of the following three ways:

1. Assuming one of ERISA's named fiduciary roles, such as plan administrator, trustee, investment advisor, etc.
2. Being appointed to a fiduciary role by a named fiduciary
3. Simply exercising decision-making or discretionary control over the plan or effectively controlling its assets, even if you were never formally delegated any authority

3 "The DOL's Move to Increase ERISA Audits," by Lin Grensing-Pophal, Human Resource Executive® Online, Thursday, April 4, 2013, www.hreonline.com/HRE/view/story.jhtml?id=534355168&ss=Erisa+Audits (accessed Nov. 19, 2014)

4 "A New Compliance Environment for 403(b) Plans," PLANSPONSOR, May 7, 2013, PLANSPONSOR.com, www.plansponsor.com/OpinionsArticle.aspx?id=6442493094 (accessed Nov. 19, 2014)

5 "Inside the Minds of Plan Sponsors," AllianceBernstein, Jan. 20, 2010, www.alliancebernstein.com/Research-Publications/Research-Articles/2010/DC_InsideTheMindsOfPlanSponsors/InsideTheMindsOfPlanSponsors.htm (accessed Nov. 19, 2014)

Are You A Fiduciary?

Check to see if your role falls into one of the following fiduciary categories:

- Anyone who has discretionary authority or responsibility in the administration of the plan, including the investment manager, plan administrator and, in some cases, board members or corporate officers
- Named fiduciaries – anyone named in the written plan document as a fiduciary. If the employer is named as fiduciary, board members and senior officers may be considered fiduciaries, even if they are unaware of the responsibility
- Anyone who gives direct or indirect investment advice for compensation with respect to plan assets or has any authority or responsibility to do so

Examples of fiduciaries may include the plan's investment manager, plan investment advisor and plan committee members. Board members or senior corporate officers may be considered fiduciaries in the absence of stated designations. Service providers such as attorneys, actuaries and third-party administrators and accountants whose work does not satisfy the definition are not considered fiduciaries. In addition, employees and service providers who are providing strictly operational functions (like the processing of forms) will not be considered fiduciaries because their work is considered "ministerial" in nature.

In other words, as a Government Accountability Office (GAO) report summarized, "Under ERISA, a person is generally a fiduciary with respect to a plan, to the extent they exercise any discretionary authority or control over plan management or any authority or control over the management or disposition of plan assets, render investment advice respecting plan money or property for a fee or other compensation (or has the authority or responsibility to do so), or have discretionary authority or responsibility for plan administration."[6]

Your Fiduciary Responsibilities — Four Basic Rules

ERISA requires that fiduciaries make decisions in the best interest of plan participants and beneficiaries. Fiduciary guidelines can be summarized in four basic rules:

1. **The exclusive benefit rule**
2. **The prudent person rule**
3. **Investment diversification**
4. **Consistency with plan documents**

Let's take a quick look at how each rule governs the conduct of a fiduciary.

1. Act exclusively in the interest of plan participants and beneficiaries.

Also known as the "duty of loyalty," the exclusive benefit rule first requires fid uciaries to act solely for the purpose of providing benefits to participants and their beneficiaries. Any decisions the fiduciary makes must take into account only the interests of the plan and its participants, not the employer. In addition, fiduciaries must not engage in activities that entail a conflict of interest with regard to the retirement plan. For example, a fiduciary may not receive marketing fees or commissions in exchange for endorsing a particular vendor.

6 United States Government Accountability Office, Report to the Chairman, Committee on Ways and Means, House of Representatives, "RETIREMENT SAVINGS – Better Information and Sponsor Guidance Could Improve Oversight and Reduce Fees for Participants," GAO-09-641, September 2009, page 9, www.gao.gov/new.items/d09641.pdf (accessed Nov. 19, 2014)

Second, the rule permits plan assets to be used for reasonable administrative expenses, such as those incurred for amendments required by law, nondiscrimination testing, Form 5500 preparation, audits and benefits calculation. However, expenses incurred for plan design are not payable from plan assets because they primarily benefit the plan sponsor.

2. Perform duties with the care, skill and diligence that a prudent person acting in a similar capacity and familiar with the matters at hand would use under the circumstances then prevailing.

This "prudent person rule," also called the "duty of care," does not require you to act as an expert. Instead, it requires that you recognize when you are not an expert and that you seek the advice of experts when it is needed, including when circumstances change. For example, this rule requires you to be familiar with "the matters at hand," which include requirements under the Pension Protection Act of 2006 and ongoing clarifications from the DOL.

3. Diversify plan investments to minimize losses, unless circumstances indicate it is not prudent to do so.

Because investment diversification[7] is a fundamental principle of investing success, it's also a fundamental feature of ERISA's requirements. The plan's investment options must also be monitored for performance, and their role in the investment option lineup must be reviewed periodically. Best practices recommend you document this process each time you review a fund and maintain the results in a due diligence file.

Although compliance with ERISA 404(c) is not required, it can protect plan fiduciaries from the consequences of participant investment directions. To comply with ERISA 404(c), participants must have the ability to choose from a broad range of investment options, as well as:

- The opportunity to exercise control over investments that materially affect the potential return on assets
- A choice of at least three investment options, each of which is diversified and has materially different risk and return characteristics
- The opportunity to diversify investments to help minimize the risk of large losses

4. Act in a manner consistent with the plan document, as long as the document is consistent with ERISA.

Consistency must be applied on both levels. For example, the plan sponsor cannot grant a plan loan that doesn't comply with the plan documents – and ERISA's conditions – without first amending the plan document to make the new conditions available to all participants.

ERISA requires fiduciaries to follow four basic rules:

1. The exclusive benefit rule
2. The prudent person rule
3. Investment diversification
4. Consistency with plan documents

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

If you don't carry out the responsibilities required of you under ERISA and fail to follow all of the appropriate processes, or if you take actions contrary to that of a fiduciary, you are considered in breach of your fiduciary duties.

Fiduciary Liabilities, Breaches And Remedies – Let's Get Personal

If you don't carry out the responsibilities required of you under ERISA and fail to follow all of the appropriate processes, or if you take actions contrary to that of a fiduciary, you are considered in breach of your fiduciary responsibilities.

ERISA holds fiduciaries personally liable for losses in the plan if they fail to perform their fiduciary duties. ERISA also provides remedies and potential consequences for breaching fiduciary duties, including:

- Personal liability to restore to the plan any losses it suffered because of the fiduciary's breach
- A 15 percent excise tax on the value of any amounts used for the breaching fiduciary's benefit
- Equitable relief as may be required by the court
- A civil penalty for a breach of 20 percent of the amount recovered from a fiduciary
- Criminal sanctions for intentionally engaging in a fiduciary violation
- Disqualification of the person from ever serving as a fiduciary for an ERISA plan

A fiduciary may also be liable for another fiduciary's breach if:

- Duties are shared (such as among committee members)
- A fiduciary is aware of another fiduciary's breach and does nothing about it
- A fiduciary fails to monitor another fiduciary's performance when required

One of the biggest fiduciary concerns under ERISA is that a plan fiduciary can be held responsible for an individual participant's investment choices.

Limitations On Fiduciary Liability Under ERISA

One of the biggest fiduciary concerns under ERISA is that a plan fiduciary can be held responsible for an individual participant's investment choices. ERISA section 404(c) provides protection from this potential exposure. If the requirements of Section 404(c) are satisfied, the fiduciary can be relieved of responsibility for the investment decisions of plan participants in their individual accounts.

There are specific rules that a plan must satisfy to obtain the protection offered under Section 404(c), including allowing the participant to exercise control over the assets in the account and to choose from a broad range of investment alternatives. Regardless of whether or not Section 404(c) is satisfied, fiduciaries still retain the responsibility to select investment options prudently and monitor them on an ongoing basis.

Take These Steps To Help Protect Yourself, Fellow Fiduciaries And Participants

Partnering with a knowledgeable and experienced retirement plan advisor or consultant is the first step. Your advisor or consultant will guide you through the maze of evolving laws and requirements and help you protect the best interests of your participants and fiduciaries. Focus on these key steps:

1. Create or strengthen your Investment Plan Statement (IPS).

Define and follow a clear written investment selection and monitoring process.

2. Appoint a Fiduciary Committee.

Write a committee charter and hold regular meetings. By setting up a committee and following your IPS, you may help create a "buffer zone" to separate board members and corporate officers who are not on the Fiduciary Committee from plan responsibilities and liabilities.

3. Partner with a provider that offers a high level of fiduciary support and impartial advice while remaining revenue neutral.

The Government Accountability Office (GAO) and many plan advisors recommend using a request for proposal (RFP) process to select investment and service providers. GAO-09-641 states, "Sponsors can also issue a request for proposal (RFP) to lower costs and decrease fees charged to participants. In response to an RFP, vendors submit bids describing their services and fees to the sponsor. Sponsors may then choose vendors who meet their participants' needs and may choose vendors with lower fees. For example, one expert told us that a statewide plan reduced total participant fees significantly because they issued an RFP and chose service providers with lower fees."[8]

4. Evaluate, select and monitor investments.

Reviewing plan investment options on a regular yearly or quarterly basis is considered a best practice.

Your advisor or consultant will guide you through the maze of evolving laws and requirements and help you protect the best interests of your participants and fiduciaries.

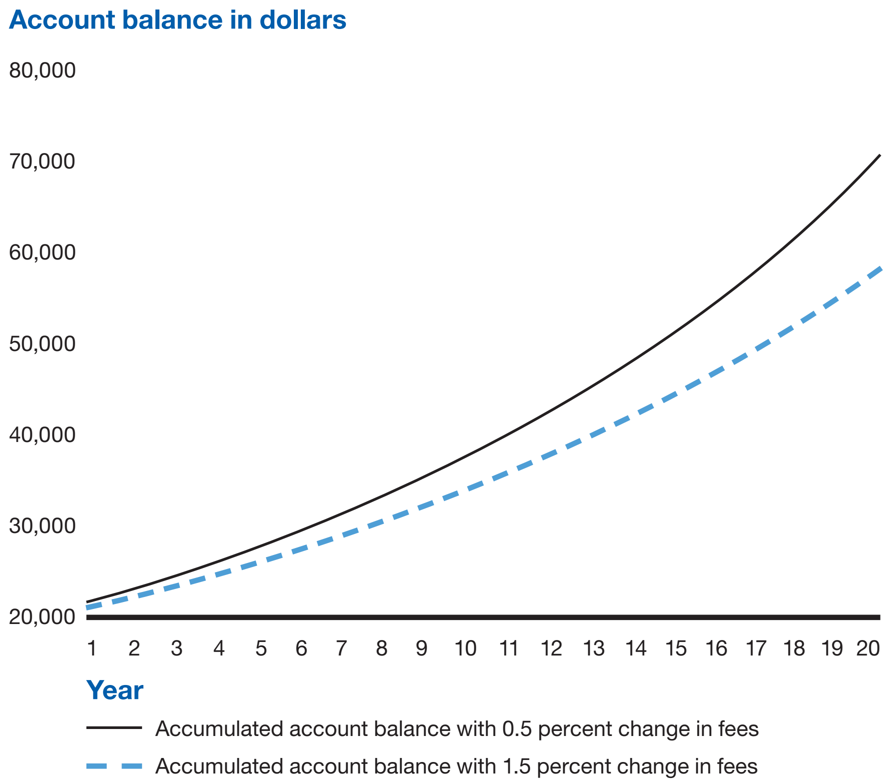
8 GAO-09-64, September 2009, page 19, www.gao.gov/new.items/d09641.pdf (accessed Nov. 19, 2014)

Partnering with a knowledgeable and experienced retirement plan advisor or consultant is the first step toward helping protect yourself, fellow fiduciaries and participants.

5. Fully disclose fees and avoid improper transactions.

Under ERISA 404a-5, plan sponsors must now disclose all plan fees to plan participants. They must also avoid improper transactions, including improper payment of expenses by the plan, delinquent participant contributions, and below-market interest rate loans to parties in interest.

Effect of one percentage point in higher annual fees on a $20,000 DC Plan balance invested over 20 years[9]



Source: GAO analysis

6. Give participants access to appropriate and timely educational materials and resources – not advice – including plan-related information and generic investment information.

Ask your plan advisor or plan provider about educational resources.

7. Document everything!

The plan may be audited at some point, in which case it will be necessary to provide accurate and detailed records to avoid fines and penalties.

9 GAO-09-641, September 2009, page 21, www.gao.gov/new.items/d09641.pdf (accessed Nov. 19, 2014)

8. **Watch out for FABs (Field Assistance Bulletins) and updates from your advisors.**

   The DOL issues FABs, which are public statements with practical interpretations of its rules and regulations related to ERISA.

Putting Fears To Rest With The Right Support

Fortunately, there is help for plan sponsors navigating these requirements. Even small plans can get valuable support from an unbiased, experienced retirement plan advisor. An initial review of your current plan will point out strengths and potential vulnerabilities. Your advisor can help you understand and execute the steps necessary to protect yourself and your participants. Ultimately, you'll have a stronger plan designed to help your participants achieve their retirement savings goals.

Valuable Resources

- Your retirement plan advisor or consultant
- U.S. Department of Labor: www.dol.gov/ebsa
- Internal Revenue Service: www.irs.gov
- Fix-It Guides – Common Problems, Real Solutions: www.irs.gov/Retirement-Plans/Plan-Sponsor/Fix-It-Guides-Common-Problems-Real-Solutions
- www.403bwise.com
- www.businessofbenefits.com
- www.benefitslink.com
- www.plansponsor.com
- IRS FAQs on Final 403(b) Regulations: www.irs.gov
- ASBO International: "Fiduciary Issues and the Final 403(b) Regulations FAQs" (for public schools and community colleges), www.asbointl.org

A Checklist For Fiduciaries

As a retirement plan fiduciary, ERISA requires you to manage your plan with the care, skill and diligence of a prudent person acting in a similar capacity.

To help meet ERISA's requirements associated with your fiduciary role for plan investments, review this checklist each year with your advisor or service professional. Check off or provide details on items that apply to your plan.

Investment Policy Statement (IPS)

- ☐ A signed and dated copy of the IPS is on file.
- ☐ All funds in the plan are covered by the IPS.
  - ☐ For funds not covered by the IPS, supporting documentation explaining each fund's exclusion is on file.

Investment Review Process

- ☐ Reports monitoring funds against IPS criteria are on file for all quarters.
  - ☐ Used The Standard's *Quarterly Monitoring Report*
  - ☐ Used report provided by advisor
  - ☐ Used other resources: ______________________________
- ☐ Fund expense ratios are reasonable for their asset classes compared to the industry averages.
- ☐ Funds used by the plan earn revenue sharing from fund companies (e.g., sub-t/a and 12(b)-1 fees).
  - ☐ What is the revenue sharing amount for each mutual fund option?

    ____

    For what purpose is the revenue sharing used? ______________________________
- ☐ Investment committee meeting minutes, including names and attendance of all active committee members, are on file for each meeting.
- ☐ The fiduciaries are aware of their fiduciary roles and responsibilities.
- ☐ A list of fund change recommendations for the year to date is on file.
- ☐ An authorization form for fund changes or additions is on file.
- ☐ Statements for illiquid assets or assets held outside The Standard are on file, if applicable.
- ☐ No plan assets have been sold to a party in interest.

Section 404(c) Compliance

☐ The plan intends to follow Section 404(c). If no, proceed to the next section.
If yes, review the following criteria to verify the plan's ongoing practices meet 404(c) requirements.

For your plan to comply with Section 404(c), at a minimum it must meet the following criteria:

1. Offer at least three different, internally diversified investment options with materially different risk and return characteristics.
2. Allow participants to transfer their assets among the options as often as appropriate given the market volatility of the options.
3. Give participants the opportunity to obtain enough information to make educated investment decisions, including:
   - A statement that the plan intends to satisfy the requirements of Section 404(c) and the effect of compliance
   - The participant fee disclosure notices described in ERISA regulation 404a-5
   - For plans with employer stock, information regarding the purchase, holding and sale of such securities, and on the exercise of voting or other rights
   - The name, address and phone number of the fiduciary representatives who can provide this information
4. Upon request, the plan must also provide the following for plan investment options:
   - Copies of prospectuses or summary prospectuses
   - Copies of financial statements, statements of additional information, shareholder reports or any similar information
   - A statement of the share or unit value of each investment option, and the date of the valuation
   - A list of the assets that comprise the portfolio for each investment option, and the portion of the investment it comprises

Qualified Default Investment Alternative (QDIA)

☐ The plan has a QDIA. (If no, proceed to the next section.)
Which fund(s) act as the QDIA? ______________________________

Managing The Investment Advisor

☐ The investment advisor agreement(s) are signed and on file.

☐ The advisor's compensation and duties are defined in the signed advisor agreements.
How is the advisor paid? ☐ Deducted from plan ☐ Paid by employer

☐ The advisor's work product, recommendations and other examples of the advisor's work on behalf of the plan are on file.

This paper is intended for distribution to advisors and plan sponsors only.
Do not distribute to plan participants.

The Standard
1100 SW Sixth Avenue
Portland OR 97204

www.standard.com