Fiduciary Responsibilities and Oversight for Deferred Compensation Retirement Plans

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Discussion Topics

- Navigating the Changing Fiduciary Landscape
- Employer Responsibility vs. Fiduciary Responsibility
- Who is a Plan Fiduciary?
- Fiduciary Standards of Conduct
- Fiduciary Functions
- Common Mistakes to Avoid
- Reducing Fiduciary Liability

The Changing Fiduciary Landscape

- Eligible 457(b) plans enacted in 1979.
- For 20 years, employers had limited fiduciary responsibility for their 457(b) plans because plan assets did not have to be held in trust.
- Employers took “hands off” approach
- This approach sometimes led to multiple providers and high fees.
  - Most providers offered proprietary funds only.
  - Some plan sponsors used multiple recordkeepers to achieve investment diversity.
- Effective 1999, all assets in a governmental 457(b) plan must be held in trust.
- Trust requirement imposed additional fiduciary responsibility on plan sponsors.

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The Changing Fiduciary Landscape

- Governmental plans are not subject to the Department of Labor's Employee Retirement Income Security Act (ERISA), BUT
- Plan fiduciaries are often held to similar standards of conduct under state law.
- Essential to understand which plan functions are performed as an employer (non-fiduciary) versus those performed as a plan fiduciary.
- Numerous lawsuits filed by plan participants against plan sponsors highlight the important and difficult responsibilities plan fiduciaries are charged with.
- This session sets out the basic standards of conduct, the lessons to be learned from participant lawsuits and ways to minimize fiduciary liability.

The Changing Fiduciary Landscape

- DC plans are one of the fastest-growing segments of the retirement industry..
- Healthcare and retirement plans result in large tax expenditures, thus:
  - Legislators may look to reduce plan contributions to increase tax revenues.
  - Scrutiny and regulation of plans will continue as regulators seek to promote retirement security.
- Plan participants are suing their plan sponsors.
- Changing landscape is forcing plan sponsors to make changes based upon:
  - Lessons learned from court decisions.
  - Increased oversight by the IRS.
  - Increased pressure for fee transparency due to DOL's fee disclosure and fiduciary regulations.
  - Increased emphasis on retirement readiness.

Participant Allegations Against Plan Fiduciaries

- Recent 401(k) lawsuits brought by plan participants against plan sponsors are very instructional.
- At issue in the lawsuits are whether plan fiduciaries:
  - Acted prudently in selecting and monitoring plan investments and making changes when warranted,
  - Understood service agreement, compensation arrangements, and
  - Ensured plan fees are reasonable, and properly disclosed.
- Court decisions are based more on the process fiduciaries use rather than the particular result obtained.

Participant Lawsuits/Settlements

- Some Lawsuits focus on duty to act solely in the best interest of plan participants.
- Actions that prompted these lawsuits are probably not unique to companies being sued.
- Most of the cases are NOT the result of fraudulent activity.
- Cases boil down to the fact that the retirement plan committees lacked a disciplined process for administering the plan.

Participant Lawsuits/Settlements

- Plan sponsors found liable for breach of fiduciary duties when they failed to:
  - Follow prudent processes in investment selection, monitoring, and replacement,
  - Ensure fees for investments and services were reasonable,
  - Monitor service providers' performance,
  - Follow governing plan documents, or
  - Document their prudent decision-making processes.
- Plan sponsors have been ordered to reimburse the plans for millions of dollars.

Large University 403(b) Plans Targeted

- Suits allege that sponsors did not act in the best interest of participants when, among other things, they allowed their plans to:
  - Use multiple recordkeepers on the plan
  - Include too many investment choices in the plan leading to “decision paralysis” and higher than reasonable fees
  - Offer duplicative investments “in every major asset class and investment style”
  - Pay asset-based recordkeeping fees rather than a per participant charge
  - Offer funds with high fees and/or restrictions.

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Supreme Court Ruling in Tibble vs. Edison

- The U.S. Supreme Court reached a unanimous opinion on May 18, 2015.
- Fiduciaries may be liable to plan participants for not conducting a "regular review of its investments with the nature and timing…contingent on circumstances" even when the initial investment selection occurred more than six years ago (outside the standard statute of limitations.)
- Fiduciaries have "a continuing duty – separate and apart from the duty to exercise prudence in selecting trust investments at the outset – to monitor, and remove imprudent investments."
- Lessons - The role of a fiduciary is active, not passive, and fiduciaries have an ongoing duty to monitor.

Lessons Learned from Lawsuits

- Court decisions turn on fiduciary prudence and operating the plan in compliance with plan documents, including the Investment Policy Statement.
- Opportunity to learn valuable lessons and adopt best practices for managing fiduciary processes and responsibilities.
- Lesson: Fiduciary prudence is process driven, not outcome driven.
- Key: Fiduciary success depends upon:
  - Basing every plan decision on what is best for your plan participants,
  - Complying with your governing documents, and
  - Prudently fulfilling each of your duties to monitor investments, service providers and fees, and
  - Making changes when warranted.

Employer versus Fiduciary Responsibility

- Offering a retirement plan involves both employer and fiduciary functions.
- Employer responsibilities include, among others:
  - Deciding whether to offer a retirement plan, or other benefits, to employees,
  - Establishing the plan,
  - Designing the plan's benefits and features,
  - Determining who will be eligible to participate,
  - Amending the plan to add or remove optional provisions, such as loans or Roth accounts, or
  - Terminating the plan.
- Fiduciary responsibilities include implementing the employer's decision:
  - Keeping the plan documents updated,
  - Administering the plan in compliance with the plan documents,
  - Selecting, monitoring and changing investment options,
  - Selecting, monitoring and changing service providers,
  - Establishing policies and procedures for the plan, and
  - Ensuring all fees are reasonable.

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Employer Decision: Adopting a Retirement Plan

- Perhaps the biggest mistake local governments make in maintaining their retirement plan is not recognizing they are plan fiduciaries.
- Local governments adopting their own plans are plan fiduciaries, *subject to fiduciary standards of conduct and liability,* when:
  - Implementing the plan decisions made by the employer.
  - Administering and operating the plan.
  - Establishing policies and procedures for the plan.
  - Selecting and monitoring the plan's investment options and making changes as needed.
  - Selecting and monitoring service providers to assist with the plan and making changes when in the best interest of plan participants.
  - Ensuring all fees for investments and services are, and continue to be, reasonable.

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Identifying Plan Fiduciaries

- Fiduciary status is based on functions performed, not a person's title.
- Anyone who has the discretion to manage or administer the plan or exercise control over plan assets is probably a fiduciary.
- A plan's fiduciaries include the plan sponsor as well as:
  - Trustees,
  - Investment advisors,
  - Members of the plan's administrative committee, and
  - Members of the plan's investment committee.
- Staff members may be fiduciaries if they exercise discretion or interpret the plan document.
- Employees who don't realize they are fiduciaries or who don't know the basic rules may inadvertently breach their fiduciary responsibility.

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Third Parties Retained by the Plan

- Another mistake plan sponsors make is thinking that selecting third parties to assist with the plan relieves them of their fiduciary liability.

- Third parties are typically *not* fiduciaries.

- Non-fiduciary experts provide information or act on instructions from plan sponsor or participants and include:
  - Accountants,
  - Actuaries,
  - Attorneys,
  - Auditors,
  - Investment consultants, and
  - Recordkeepers and other service providers.

- Investment advisers will likely be fiduciaries if they provide investment advice for a fee or make decisions on behalf of the plan.

Plan's Committee - Best Practices are Key

- Properly structure the plan's committee and their activities:
  - Select qualified, committed people.
  - Select individuals with sufficient time to devote to prudent oversight of plan administration, investment options, operation and service provider(s).
  - Put regularly scheduled meetings on the calendar.
- Train plan fiduciaries:
  - Educate fiduciaries on their basic fiduciary duties.
  - Be sure fiduciaries understand they are the ones responsible for properly administering the plan, not the trustee or service provider or consultants.
- A sound fiduciary governance process:
  - Enhances the participant experience, and
  - Reduces liability of employer, Board or Committee members and other fiduciaries.
- Document decisions as well as the prudent, deliberative process that was followed in making all plan-related decisions.

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Fiduciary Standards of Conduct

- State laws often mirror or are very similar to ERISA, and that is true in Virginia.
- Most governmental plans also use Employee Retirement Income Security Act of 1974 (ERISA) rules as a guide and best practice.
- Basic ERISA fiduciary principles found in Virginia's adoption of the Uniform Prudent Investors Act, including duties of loyalty and prudence.

Duty of Loyalty – Avoid Conflicts of Interest

- The duty of loyalty is known as the exclusive benefit rule.
- Plan fiduciaries must act solely in the best interests of the plan participants and for the exclusive purpose of providing plan benefits.
- Fiduciaries cannot put employer interests before those of plan participants.
- Carefully consider potential conflicts of interest in light of the duty of loyalty.
- Once fiduciaries understand the duty of loyalty to the plan, all the rest is common sense.

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Duty of Prudence

- Duty of prudence requires fiduciaries to act with the care, prudence, skill and diligence a knowledgeable person administering a retirement plan would use.
- Prudence is one of most important duties because it comes into play in every activity undertaken and every decision made by the fiduciaries.
- Prudence is more than just an obligation to be competent and careful in your conduct.
- Prudence requires the use of good judgment and sound processes when handling the affairs of the plan.
- Virginia follows the Uniform Prudent Investor Act.

Develop a Prudent Process

- Prudence focuses on the process fiduciaries follow in making fiduciary decisions.
- A careful, diligent, thorough decision-making process is required:
  - Gather, examine and give appropriate consideration to all relevant information.
  - Implement the decision.
  - Periodically monitor performance to ensure the decisions continue to be right for the plan.
- Retain third parties to assist with plan decisions, if necessary.
- Keep good records of deliberations and decisions.

Fiduciary Administrative Responsibilities

- Some plan fiduciaries don't realize the scope of their fiduciary responsibilities:
  - Identifying and training the plan fiduciaries.
  - Establishing policies and procedures for the plan.
  - Administering and operating the plan.
  - Selecting and monitoring plan's investment options.
  - Making investment changes where warranted.
  - Selecting and monitoring trustees, service providers, consultants and others.
  - Ensuring the investment and service provider fees are reasonable.
  - Maintaining documentation of all plan-related decisions.
  - Repeat.

- Local governments generally have all of these fiduciary duties for their 457(b) plans – multiplied by the # of vendors.

Administering the Plan is Important

- 457(b) plan administration is as important as investment selection:
  - Keep the plan document in compliance with Internal Revenue Code and regulations.
  - Include all required provisions and each optional feature you are offering participants – it is your contract with the participants.
  - Read plan document thoroughly and be sure you understand each and every provision.
- The plan document is plan fiduciary's manual for administering the plan.
  - Compare plan policies, procedures and forms to the terms of the document.
  - Revise any procedures that do not exactly match the document.
- Failure to operate the plan in compliance with governing documents is a top IRS audit "catch-all" and can cause the plan to become ineligible.
- The key is being knowledgeable and acting sensibly when making decisions on behalf of the plan.

Selecting, Monitoring and Deselecting Investments

- State laws generally require and courts have agreed, that fiduciaries must use reasonable diligence when selecting, monitoring and replacing plan investments.
- Unanimous decision of US Supreme Court in Tibble vs. Edison – May 18, 2015: Plan fiduciaries:
  - Have a continuing duty, separate and apart from the duty to exercise prudence when selecting investments, to monitor them and remove imprudent ones.
  - Must systematically consider all the plan's investments at regular intervals to ensure that they are appropriate.
  - Are under a duty to dispose of inappropriate investments within a reasonable time.
- Lessons:
  - The role of a fiduciary is active, not passive

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Investment Policy Statement (IPS)

- Some sponsors adopt an IPS to help them guide the process for reviewing plan investments.
- An IPS becomes a written document and might be drafted to:
  - Outline the process for making prudent investment-related decisions.
  - Define duties and responsibilities of all parties involved in investment selection process.
- IPS defines criteria and processes for investment decisions and can set out the:
  - Methodology/criteria for selecting a broad, diversified array of investments with different levels of risk and returns.
  - Goals, objectives and performance standards the funds are expected to meet to be retained in the investment menu.
  - Guidelines for monitoring and evaluating funds, and timing for terminating and replacing any nonperforming funds.
- Sponsors considering an IPS should be aware that adopting the IPS binds them to following the IPS's processes. A failure to follow the IPS may be evidence of a breach of fiduciary duty.

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Selecting/Monitoring Plan's Service Providers

- Use objective criteria.
- Establish a process for regular review of each provider's performance.
- Monitor performance of services in the contract and the fees being charged.
- Determine whether the fees paid by plan are reasonable and whether the provider has conflicts of interest that could influence plan recommendations.
- Make changes when necessary to promote the best outcomes for participants.
- Document the evaluation and decision-making process used in monitoring service providers and the basis for decisions to retain them or make a change.

Ensure Plan’s Fees are Reasonable

- Duty of Loyalty requires fiduciaries to ensure plan fees and expenses are “reasonable.”

- First, fiduciaries must know what fees are being charged to the plan and participants by each investment option and each service provider.

- Fiduciary’s job is not to find the lowest cost fund or provider – but rather to:
  - Follow the criteria in the IPS when selecting and deselecting funds (if the plan has an IPS)
  - Benchmark the quality of each provider’s services and level of fees to plans of similar size and complexity.

- The DOL "fee dislcosure“ documents from your service provider can help determine the reasonableness of fees.

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Fiduciary File Cabinet

- Plan fiduciaries must maintain a complete set of all plan documents.
- Keep signed documents in a safe, accessible place:
  - Plan documents and any summary plan materials,
  - Trust agreement,
  - Plan forms, rules and procedures,
  - Service agreements,
  - Third party contracts,
  - Investment contracts,
  - Investment Policy Statement,
  - All amendments to those documents, and
  - Committee meeting minutes.
- Local governments must keep documentation for their own plan – multiplied by the # of vendors.

Common Mistakes Employers Need to Avoid

1. Studies show 1/3 of small employers don't realize they are a fiduciary when implementing and administering a plan.
2. Thinking that if plan sponsor hires an advisor, they don't need to worry about being a fiduciary.
3. Assuming plan's service providers handle everything.

- Other common mistakes, or failures to follow best practices:
  - Not documenting plan-related decision-making processes.
  - Lack of fiduciary training and education.
  - Not knowing who the plan fiduciaries are and how duties are divided among them.
  - Not knowing how much the plan is paying in fees.
  - Not updating plan documents.
  - Having an investment/plan committee, but not meeting.
  - Having an investment/plan committee meeting, but not documenting the discussion/ decisions.
  - Not hiring an adviser when outside expertise is needed.

- NAPA.Net survey, April, 2015

Making Employer's Life Easier and Reduce Fiduciary Liability

- Consider consolidating to one recordkeeper for the plan.
- Consolidation can be an effective way to reduce and simplify fiduciary oversight and limit liability.
  - May give leverage to negotiate lower fees, since there will not be duplicative recordkeeping services and duplicative investments.
  - Substantially reduces the time and effort required to monitor multiple recordkeepers to ensure that each one is satisfying the terms of their services agreements and complying with the terms of your plan document.
  - Reduces the time required to prudently analyze and ensure that the fees charged by each of your providers are reasonable and in the best interest of participants.

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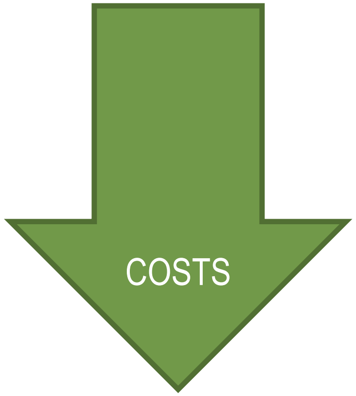
Make Life Easier and Reduce Your Fiduciary Liability

- A single recordkeeper significantly reduces the time and effort required to fulfill fiduciary responsibilities with respect to:
  - Plan design.
  - Plan administration.
  - Investment Policy Statement (IPS).
  - Investment menu selection, review and replacement.
  - Default investment option.
  - Monitoring plan administrative services and costs.
  - Monitoring investments options and pricing.
  - Participant communication and education.
- Lower fees:
  - May increase participant account balances over time.
  - Can assist participants in achieving retirement readiness



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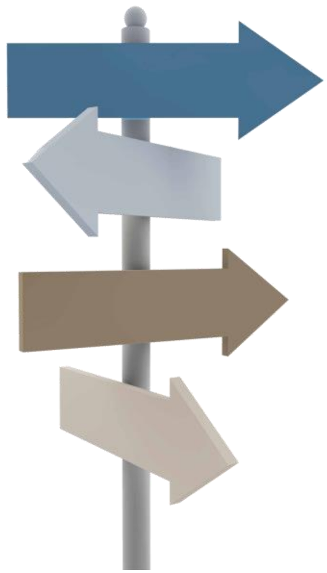
Enhance Participant Experience and Reduce Liability

- Simplify the participants' decision to participate in the plan by eliminating the initial hurdle of which vender to choose.
- Employees already have to decide:
  - Whether to enroll?
  - How much to save?
  - Which investments to select?



- One recordkeeper allows fiduciaries to focus participant communications on plan features and benefits, not sales material from vendors.
- Ongoing education programs using various mediums can be streamlined.

Employee Communications and Education – 404(c)

- Consider following ERISA Section 404(c) as a best practice in your plan.
- ERISA 404(c) allows plan fiduciaries to help avoid liability for individual participant investment decisions – a big deal! If:
  - Offer at least three diverse investment options;
  - Provide sufficient information to allow participants to make informed investment decisions with respect to their account; and
  - Provide information with respect to funds, managers and fees.
- Develop easy to understand communications/seminars for participants about:
  - Key plan features, and
  - How participating in the plan will benefit participants.
- Offer a robust website with retirement income and other calculators to allow participants to make informed choices about contribution levels, investments, etc.

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