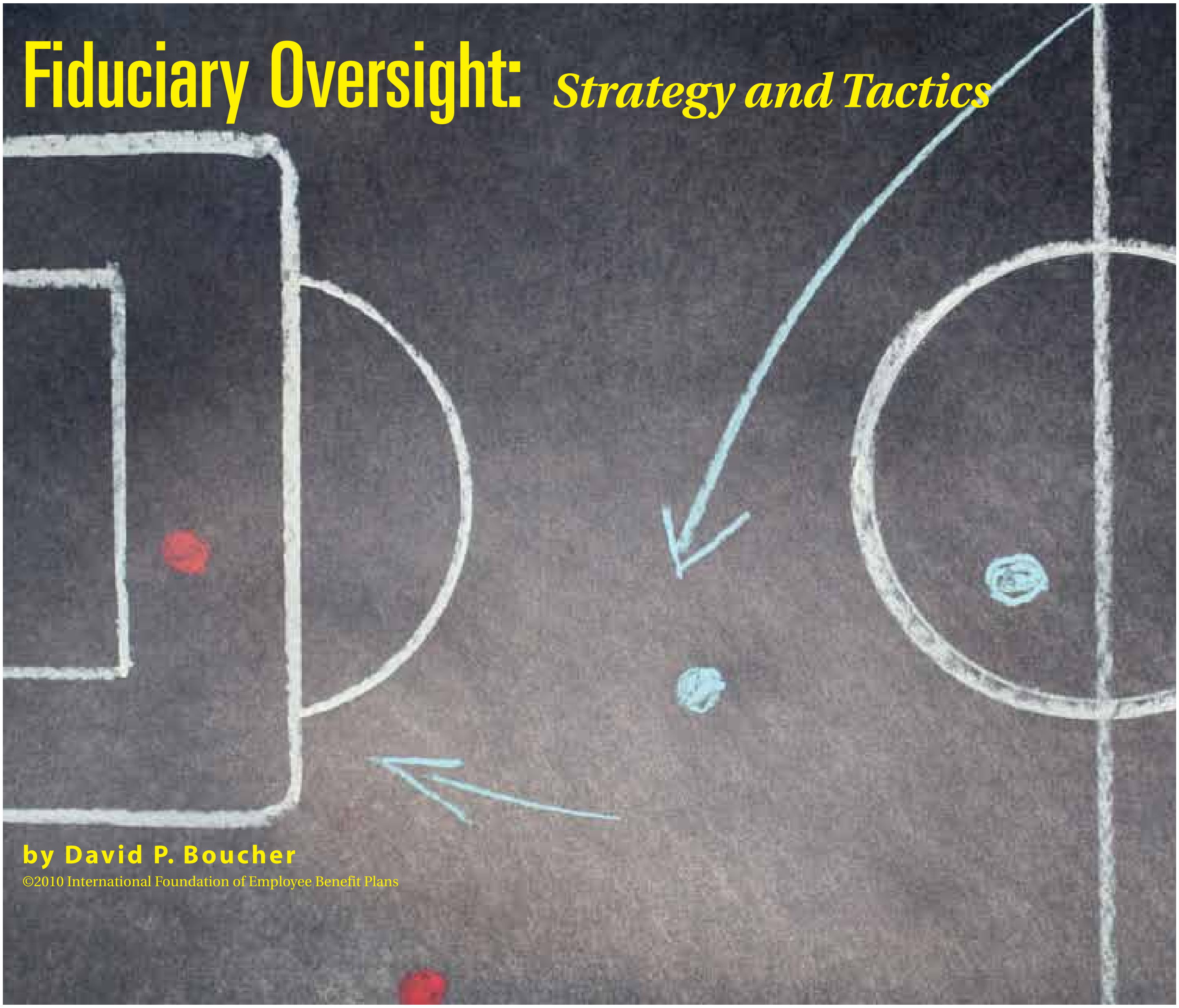
Plan sponsors are advised to take practical steps to be sure they're acting as good fiduciaries over defined contribution plans. Those steps include keeping a close watch on fees charged by retirement plan providers, staying current with legislative and regulatory changes, and following best practices in plan oversight.

Fiduciary Oversight: *Strategy and Tactics*



by David P. Boucher

Fiduciary standards and *fiduciary oversight* are terms familiar to most plan sponsors at a strategic level, but not necessarily at a tactical level. This article provides practical information from both the strategic and tactical levels.

In April 2000, I was looking for a job with an independent 401(k) advisor. As I walked into a potential employer's beautiful office, I could not help but notice the ornate detail in office space and furniture. This firm had made it, and I could prosper as I moved into the advisory role there, I thought. I was escorted into a beautifully decorated conference room where two principals were waiting for me. We quickly got into philosophies of 401(k) management and the "unique" product they had brought to the market. As they described what they were "selling" to clients, I could not help but wonder who would agree to these terms and conditions? Quickly, the two principals noticed my hesitance as they continued to describe their "industry-leading" product.

They asked if I had any clients I could bring on board with me. I mentioned to them one client with $1 million in plan assets. They quickly painted a picture for me that I will never forget.

"You could make $70,000 from that one ticket!" one principal exclaimed. "And," the other principal called out, "the commission is not reported to the client!"

I had never talked about commission or tickets in my past. The world I came from used the equation that for every $1 million in plan assets, there was $2,500 of revenue produced by the plan. To go from $2,500 to $70,000 was disgusting. I knew I needed to end this meeting and get out of that office with the jacket on my back. To make matters worse, I later learned that a client using this plan could not leave for seven years, unless the client was willing to pay a penalty.

Qualified retirement plans are supposed to be run for the benefit of employees—not vendors, brokers or plan sponsors. They shouldn't be a gold mine for anyone.

This story shows that there is ambiguity in current advisor rules and regulations. Neither a broker nor a 401(k) advisor, acting as a broker, must put a client's interests ahead of his or her own. However, a fiduciary advisor must *always* put the interests of clients over his or her own. If, as a plan sponsor, you are leveraging the guidance of a 401(k) advisor, ask if he or she is being held to a fiduciary standard, or if he or she is partnering with you in a straight brokerage relationship. There is a difference.

Here are some simple steps to ensure you are meeting your fiduciary obligations:

- Do what is right for plan participants.
- Insulate yourself from fiduciary liability.
- Adapt to legislative and regulatory changes.
- Create an effective and efficient best practice.

Do What Is Right for Plan Participants

This guideline focuses mostly on the fees being charged to plan participants versus the services offered to participants. The fiduciary standard is to ensure your participants are receiving a benefit that has reasonable fees when compared to a relevant benchmark.

For example, our team recently met with a plan sponsor that neglected to benchmark its retirement plan over the past seven years. When we benchmarked the $26 million plan, we were able to show the sponsor a way to save its participants over $100,000 in fees. Since this company had around 200 participants, the per participant savings was approximately $500 every year. In practice, this exercise should be done on an annual basis and be tracked.

As a plan sponsor, you also need to clearly understand—and document in investment committee minutes at least annually— your plan provider's required revenue and compare it to actual revenue-sharing recapture. Although an accepted industry practice, *revenue sharing* (a payment from an investment company to a recordkeeper to cover certain recordkeeping and administration costs) has come under fire in many recent court cases, all the way up to the U.S. Court of Appeals.

To be clear, *required revenue* is the per participant cost by your 401(k) plan vendor to operate your plan, with margin. As your plan grows in assets, and as the industry becomes more efficient, required revenue may decline while the actual revenue generated from your plan assets may increase. This juxtaposition is called *excess revenue*. If there is an excess revenue gap, negotiate and advocate for your plan and plan participants. Potentially, that revenue gap could benefit the plan.

Insulate Yourself From Fiduciary Liability

This focuses on a prudent process, as monitored by the Department of Labor (DOL). Plan sponsors should create an investment committee, bylaws, roles and responsibilities, and investment policy statement, and regularly document minutes of committee meetings, to be discussed below.

In addition, qualified plans are required to carry adequate fidelity or Employee Retirement Income Security Act (ERISA) bond coverage.

Moreover, plan sponsors are starting to purchase directors and officers insurance specific to the 401(k) plan. This coverage, called *fiduciary liability insurance*, has become essential in a litigious environment.

With proper process and adequate insurance, plan fiduciaries can do their part to insulate themselves from potential fiduciary liability arising from normal and customary retirement plan management.

Adapt to Legislative and Regulatory Changes

On July 15, DOL announced the much-anticipated rules around disclosure of fees charged by service providers to employee benefit plans. The deadline to comply with these rules—Fee Disclosure (Service Provider to Plan Sponsor): 408(b)2, Part Two—is slated for July 16, 2011. The new rules are aimed at assisting plan sponsors in assessing the reasonableness of contracts or arrangements, including the reasonableness of the service providers' compensation and potential conflicts of interest. This information is critical for plan sponsors to be able to evaluate their current 401(k) plan provider's services

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Fiduciary Responsibility— Additional Resources

More Information

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and fees as compared to other service providers. It is expected that plan sponsors, armed with this clarity, will take action in evaluating the competitiveness of fees and services.

What was yet to be determined as of this writing is how plan sponsors will share this fee disclosure information with participants. Perhaps DOL is leaving this component up to Congress. Recently, as part of the American Jobs and Closing Tax Loopholes Act of 2010, Rep. George Miller (D-Calif.) proposed language that dealt with the issue of disclosure to participants. Although the fee disclosure provisions were removed from the bill by the Senate, plan sponsors may eventually be required to work with recordkeepers to disclose at least annually, in real dollars, the fees participants pay for their 401(k) plan, including mutual fund/investment charges. Upon electing to participate in a 401(k) plan, participants may need to be provided with a point-of-sale fee estimate disclosure. This fee estimate would help participants to become more informed decision makers relating to 401(k) fees.

In the legislative works, plan sponsors may soon be encouraged or even required to make retirement income annuities one of the 401(k) plan investment options. This product is structured to assist older workers/participants in managing their downside market risk as they approach retirement age. As a general principle, retirement income annuities will set annual high-water marks in case the stock market drops precipitously, as it did at the beginning of the 2000s and in 2008. If a participant commences retirement, he or she has the option to annuitize his or her 401(k) plan balance at the higher of (1) the high-water mark or (2) current market value. The negative of this type of product will be found in the fees associated with the downside-risk insurance.

Create an Effective and Efficient Best Practice

In the day-to-day functions of plan sponsors, much time is spent on administrative tasks such as processing payroll, loading new-hire information into the appropriate database and setting up COBRA coverage for terminated employees. If asked, many plan sponsors feel so overburdened with day-to-day administrative tasks that they do not have time to implement best practices as they relate to fiduciary management over their 401(k) plan. So where should you start?

- *Consider hiring an independent advisor to assist in fiduciary management requirements*. In the case of *DeFelice v. US Airways*, courts found US Airways to have avoided a fiduciary breach due to the fact that the company had hired an outside expert to assist in its fiduciary obligations. In a class action case in November 2009, Caterpillar Corporation settled out of court by paying more than $16 million to plan participants and hired an independent expert to assist as a fiduciary to its qualified plan.
- *Set up an investment committee*. Investment committee members typically come from human resources, finance and a cross section of the employee base. Investment committees can have three or more members. It is important that each member understands his or her fiduciary obligation to plan participants and understands that he or she is personally liable to restore losses due to a fiduciary breach. Roles and responsibilities must be clearly defined and a committee charter implemented.
- *Have an investment policy statement (IPS) in place*. As previously mentioned, fiduciaries are personally liable to restore losses due to a fiduciary breach. When a committee adopts an IPS, it has a framework to select and monitor investments as well as manage the overall health of the plan. Two growing areas of importance in fiduciary oversight of a plan are fees and target-date investment due diligence.
- *Meet regularly*. It is imperative that once you set up an investment committee and IPS, you meet as a committee on a regular basis. There is no set frequency prescribed; however, the frequency should be no less than annually.
- *Document everything!* Keeping minutes of investment committee meetings is your opportunity to document to DOL that you accept your fiduciary responsibility to the plan and that you are adhering to a formal best practice of fiduciary management. Some critical pieces of information that should be included in the minutes are date, list of attendees, topics discussed, actions taken, rationale for decisions and any followup steps to be completed.

As the first generation of 401(k) plan participants reaches retirement age in the year 2020, 40 years after the first 401(k) was created, it is expected that the system will fall short. Over the years, as defined benefit (DB) plans shut down, 401(k) plans were looked upon to fill the void as a sole funding retirement vehicle for most Americans. It is unrealistic to expect that 401(k) plans—which originally were created to supplement a retirement shortfall from DB plans—are adequate to fund retirement.

A question likely to be deliberated at all levels for many years is: Who will pay for a retirement funding shortfall? And fiduciaries also may ask: Who can be sued to right this wrong?

From a strategic point of view, plan sponsors should focus on process. From a tactical point of view, they should focus on documentation. If successful on both levels, plan sponsors should feel confident that they are offering their employees the best retirement plan possible and insulating themselves against future liability. **B&C**

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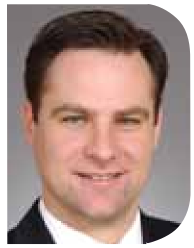

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