County Auditors' Fall State Called Conference

# Navigating the Changing Fiduciary Landscape

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## Discussion Topics

- 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 Your Fiduciary Liability

## The Changing Fiduciary Landscape

- Eligible 457(b) plans enacted in 1979 – no fiduciary responsibility:
  - All plan assets belonged to the employer.
  - Employers took "hands off" approach.
  - Most providers offered proprietary funds only.
  - Some plan sponsors used multiple recordkeepers to achieve investment diversity.
- Fiduciary responsibility imposed on plan sponsors now that plan assets must be help in trust exclusively for participants.
- Fiduciaries are held to the highest standards under the law!
- Essential to understand which functions you perform as an employer 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.
- We will focus on lessons from such lawsuits and ways to minimize fiduciary liability.

## Employer versus Fiduciary Responsibility

- Offering a retirement plan involves both employer and fiduciary functions.
- Employer responsibilities include, among others:
  - Deciding whether to offer a 457(b) plan, or other benefits, to employees,
  - Establishing the plan,
  - Designing the plan's benefits and features,
  - Determining who is 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.

## Employer versus Fiduciary Responsibility

- In Indiana, you are fortunate to have the option of choosing to participate in the Hoosier S.T.A.R.T. 457(b) plan.
  - Indiana Code (IC) 7(b)(2) or 7(b)(3) 5-10-1.1-4
- You may also establish and maintain your own separate defined contribution plan.
- Today, we will review how each of these decisions impacts you as an employer and plan sponsor.
  - Adopting the Hoosier S.T.A.R.T. plan – employer responsibilities only;
  - Adopting your own plan – employer PLUS fiduciary responsibilities – so we will look at some best practices for fulfilling that fiduciary responsibility and reducing your potential liability.

## Employer Decision: Adopting Hoosier S.T.A.R.T.

- Adopting the Hoosier S.T.A.R.T. – You, as the employer:
  - Decide to participate in the State Plan.
  - Accept the design of the State plan.
  - Agree to comply with the adopting employer functions, including timely transmission of deferrals into the plan and obeying the governing laws and plan documents.
- The Hoosier S.T.A.R.T. Deferred Compensation Committee, as the plan fiduciary, handles the fiduciary responsibilities for you.
- Your continuing employer responsibility - Review State plan from time to time (as you do with your other employee benefits) to determine Hoosier S.T.A.R.T.:
  - Continues to be a valuable benefit to your employees, and
  - Is being prudently administrated by the State.

## Employer Decision: Adopting Your Own Plan

- You decide to establish and maintain your own plan separate from the State's plan.
- #1 biggest mistake employers make in maintaining their own retirement plan is not recognizing they are plan fiduciaries.
- You are a plan fiduciary, *subject to fiduciary standards of conduct and liability,* when:
  - Implementing the plan decisions made by the employer.
  - Administering and operating your plan.
  - Establishing policies and procedures for the plan.
  - Keeping the plan document updated for all required changes in law.
  - 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.



## Identifying Your Plan's 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 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 not realizing they are fiduciaries or who don't know the basic rules may inadvertently breach their fiduciary responsibility.



## Third Parties Retained by the Plan

- #2 biggest 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 be fiduciaries if they provide investment advice for a fee or make decisions on behalf of the plan.



## Your Plan's Committee - Best Practices are Key

- Properly structure your 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 your plan fiduciaries:
  - Educate your fiduciaries on their basic fiduciary duties.
  - Be sure they understand they are the ones responsible for properly administering the plan, not your 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 your decisions and the prudent, deliberative process that was followed in making all plan-related decisions.



## Fiduciary Standards of Conduct

- State laws often mirror or are very similar to ERISA, and that is true in Indiana.
- 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 Indiana Statutes include:
  - Duty of loyalty - IC 5-10-1.1-4 (d) Assets must be put into a trust for the exclusive benefit of plan participants, as required by Code § 457(g)
  - Duty of prudence – IC 30-4-3.5-1 - 7,
  - Duty to diversify plan assets – IC 5-10-1.1-4(c)
  - Duty to monitor funds and providers and make changes when warranted, and
  - Duty to follow terms of plan documents.



## Duty of Loyalty – Avoid Conflicts of Interest

- The duty of loyalty is known as the exclusive benefit rule – IC 30-4-3.5-5.
- 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.
- Avoid conflicts of interest at all cost.
- Once you understand the duty of loyalty to the plan, all the rest is common sense.

## Duty of Prudence – IC 30-4-3.5-1-7

- 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.
- Indiana follows the Uniform Prudent Investor Act.



## Indiana Prudent Investor Rule

- IC 30-4-3.5-1: Fiduciary owes a duty to plan participants to comply with the prudent investor rule.
- IC 30-4-3.5-2(a): Fiduciary shall invest and manage trust assets as a prudent investor would and in satisfying this standard, shall exercise reasonable care, skill, and caution.
- IC 30-4-3.5-3: Fiduciary shall diversify the investments of the trust unless he/she reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying.
- IC 30-4-3.5-5: Fiduciary shall invest and manage the trust assets solely in the interest of the beneficiaries – duty of loyalty.
- IC 30-4-3.5-7: In investing and managing trust assets, Fiduciary may only incur costs that are appropriate and reasonable.



## 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 you, if necessary.
- Keep good records of your deliberations and decisions.



## Fiduciary Administrative Responsibilities

- Plan fiduciaries don't always realize scope of their fiduciary responsibilities:
  - Identifying and training the plan fiduciaries.
  - Designing and implementing the plan.
  - Establishing policies and procedures for the plan.
  - Administering and operating the plan.
  - Keeping the plan document updated for all law changes.
  - Selecting and monitoring plan's investment options pursuant to a written Investment Policy Statement (IPS) – IC 30-4-3.5-3.
  - 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.
- State handles these responsibilities for Hoosier S.T.A.R.T.
- You have all of these fiduciary duties for your own plan – multiplied by the # of vendors.



## Administering the Plan is Important

- If you maintain your own 457(b) plan, you must:
  - 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 your 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 law requires, and courts have agreed, that fiduciaries must adopt prudent investment policies and use reasonable diligence when selecting, monitoring and replacing plan investments.
- Unanimous decision of US Supreme Court in Tibble vs. Edison – May 18, 2016: 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,
  - Fiduciaries have a duty to adopt and follow an Investment Policy Statement (IPS), and replace funds pursuant to that IPS.

## Investment Policy Statement (IPS) for Your Plan

- Prudent investment policy = adopting and following an IPS for plan investments.
- An IPS is a written governing plan document and should:
  - 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 should 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.
- IPS should require regular meeting schedule for evaluating the current investment menu and initiating changes when necessary.



## Selecting/Monitoring Your 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 that the provider has no 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 your decision to retain them or make a change.



## Ensure Your Plan's Fees are Reasonable

- Duty of Loyalty requires you to ensure plan fees and expenses are "reasonable" – also IC 30-4-3.5-7.
- First you must know what fees are being charged to the plan and participants by each investment option and each service provider.
- Your job is not to find the lowest cost fund or provider - your job is to:
  - Follow the criteria in your IPS when selecting and deselecting funds, and
  - Benchmark the quality of each provider's services and level of fees to plans of similar size and complexity.
- Obtain the same fee disclosure documents your service provider is required to provide to ERISA clients - use it to help determine the reasonableness of fees.



## 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.
- State handles this for Hoosier S.T.A.R.T.
- You must keep documentation for your own plan – multiplied by the # of vendors.



## Common Mistakes to Avoid to Reduce Your Liability

- #1 mistake - studies show 1/3 of small employers don't realize they are a fiduciary when implementing and administering a plan.
- #2 mistake - thinking that once you hire an advisor, you don't need to worry about being a fiduciary.
- 3# mistake - Assuming your service providers handle everything.
- Other most-cited mistakes were:
  - Not documenting your 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



## Lawsuits Against Plans with Multiple Recordkeepers

- Multiple participant lawsuits filed in recent years charge fiduciaries with making imprudent decisions resulting in excessive fees.
- New charges filed against more than a dozen university plans claim participants were charged excessive fees due to:
  - Duplicative recordkeeping services provided by multiple recordkeepers, and
  - Too many investments - leading to "decision paralysis" and higher than reasonable fees.
- Other allegations included in the university cases:
  - duplicative investments "in every major asset class and investment style";
  - paying asset-based recordkeeping fees rather than a per participant charge;
  - using specific stock and money market accounts subject to restrictions;
  - using retail mutual funds with higher fees than identical institutional share class funds;
  - using mutual funds rather than collective investment funds or separately managed accounts;
  - offering active management solutions rather than passive ones.

## Make Life Easier and Reduce Your Fiduciary Liability

- Employers participating in the Hoosier S.T.A.R.T. plan:
  - You are not responsible for the long list of fiduciary functions we discussed – Hoosier S.T.A.R.T. handles those responsibilities for you.
  - You still must fulfill certain employer functions – such as timely forwarding deferrals to the plan, etc.
- Hoosier S.T.A.R.T. has adopted many of the prudent practices at issue in recent lawsuits, including:
  - A single recordkeeper,
  - A limited number of investment options: 10 Age-based funds and 14 individual funds,
  - A fixed participant charge of $14.45 per quarter for recordkeeping fees; not an asset based charge.
  - All investment options are institutional class shares; not retail class.



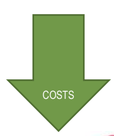
## Make Life Easier and Reduce Your Fiduciary Liability

- Simplify your own plan to minimize your fiduciary duties and potential liability:
  - You have ultimate fiduciary responsibility for administering and operating your own plan,
  - Your fiduciary duties and liability cannot be outsourced or relinquished.
- Consolidate to one recordkeeper for your plan – the single most effective way to reduce and simplify your fiduciary oversight and limit liability.
  - Eliminates higher fees due to 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.



## Make Life Easier and Reduce Your Fiduciary Liability

- Single recordkeeper significantly reduces the time and effort required to fulfill your 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:
  - Dramatically increase participant account balances over time.
  - Improve participant retirement readiness.






## 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 – they already have to decide:
  - To enroll?
  - How much to save?
  - Which investments?
- Focus participant communications on plan features and benefits, not sales material from vendors.
- Provide ongoing education programs using various mediums.
- Limit your fiduciary liability by providing ERISA 404(c) information.



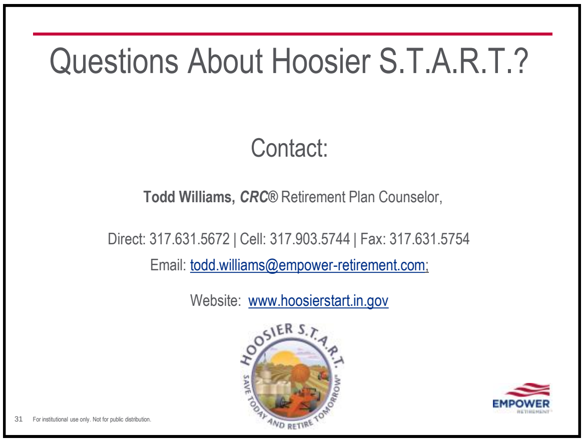
## Employee Communications and Education – 404(c)

- ERISA 404(c) allows plan fiduciaries to 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.
- Important part of fulfilling your fiduciary responsibilities and reducing your liability.
- 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.



## Some Good News – Chevron 401(k) Case

- Judge dismissed all charges, holding that:
  - Fiduciaries may value investment features other than price (an in fact are required to do so).
  - Mere allegation less expensive funds are available is insufficient to state a cause of action in the absence of a flawed investment selection process.
- Plaintiffs' claim: Plan changes made prior to litigation = proof of fiduciary breach.
- Judge's ruling: Changes made by fiduciaries = evidence of their ongoing prudence.
- Lesson: Fiduciary prudence is process driven, not outcome driven.
- Key: Fiduciary success will be yours if you:
  - Base every plan decision on what is best for your plan participants,
  - Comply with your governing documents, and
  - Prudently fulfill all of your duties to monitor investments, service providers and fees, and
  - Make changes when warranted.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