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 held 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 Decision: Adopting Hoosier S.T.A.R.T.

- 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 Your Own Plan**

- You decide to establish and maintain your own plan separate from the State’s plan.
- #1 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,
  - 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.

**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,
  - Attorneys,
  - Auditors,
  - Investment consultants, and
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**Fiduciary Standards of Conduct**

- State laws often mirror or are very similar to ERISA, and that is true in Indiana.
- 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.

**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.

**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.

**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 the 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.

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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.

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.

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.

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 agreements.
  - 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.

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.

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**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.

**Enhance Participant Experience and Reduce 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.

**Employee Communications and Education – 404(c)**

- ERISA 404(c) allows plan fiduciaries to avoid liability for individual participant investment decisions – a big deal!
  - 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.
Questions About Hoosier S.T.A.R.T.?

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