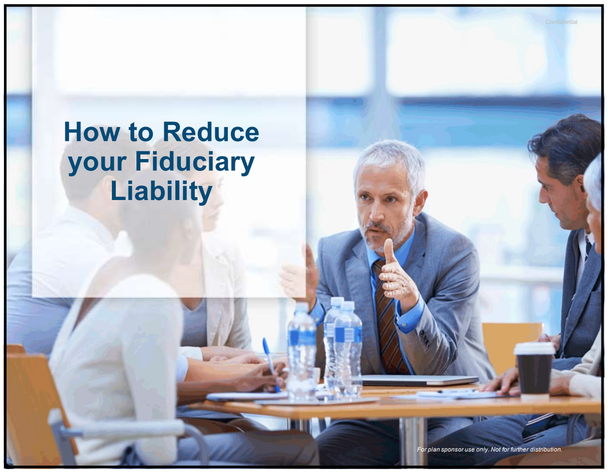
How to Reduce your Fiduciary Liability



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The Two-Step Tango

1. Utilize ERISA safe harbors
2. Implement a sound risk management process

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The Two-Step Tango

- Plan sponsors are held to a "prudent man" standard
- Unfortunately the government does not define that standard
  - Some guidance and relief in ERISA safe harbors
- Use existing legislation to reduce your liability and implement a sound risk management process
  - Both helps improve outcomes and meet government expectations

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Prudent Expert Act

- A measure contained in section 404(a)(1)(B) of the Employee Retirement Income Security Act (ERISA) that requires the fiduciary of a defined contribution retirement plan to use "care, skill, prudence and diligence", and to act in the same way that someone "familiar with such matters" would act. The "familiar with such matters" language has been interpreted to mean "expert". This language creates an important distinction from the earlier prudent person guideline, in that it holds fiduciaries to a stricter standard.

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Step 1 - Take Advantage of the ERISA Safe Harbors

The federal government recognizes that plan sponsors want to do the right thing. To that end they have tried to encourage certain actions by offering some safe harbor exemptions that can help reduce a plan sponsor's liability. The questions you should be answering are:

1. Are you taking advantage of these opportunities to reduce your liability?
2. If you're not, why aren't you?

Let's identify the six steps and dig a little deeper into each.

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Step 1 - Take Advantage of the ERISA Safe Harbors

1 **Investment Management**	2 **Administration**	3 **Participant Enrollment**
4 **Participant Contributions**	5 **Participant Direction**	6 **Participant Advice**

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Investment Management

Co-Fiduciary
(share liability)

Discretionary Investment Manager
(outsource liability)

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Investment Management

Action Steps:

- Determine whether your current broker or advisor has accepted either of these fiduciary statuses.
  - If they are not, your committee should determine what value they provide.
- If you have not hired an investment expert, you should identify the background, skills and knowledge of whomever on your committee is assuming that role.

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Administration

Loans

Hardship Withdrawals

Terminating Distributions

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Administration

There are a number of administrative tasks that you can outsource to vendors reducing your liability and responsibility. These duties are typically assumed by the recordkeeper or third party administrator. Most of these tasks have to be dealt with in accordance with the terms of your plan document. If you retain these tasks in house it is your responsibility to ensure that staff handles them properly. Here is a list of items you can outsource via this safe harbor:

- Eligibility Determination/Notices
- On-going Benefit Claims Processing
- Approval for Participant Loans/Hardships
- Approval of QDROs
- Plan Compliance
- Annual Mailings
- Fund Change Mailings
- Government Reporting and Forms

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3(16)(A) FIDUCIARY ADMINISTRATION SERVICES

Plan Operational Oversight And Compliance

- Accept responsibility under ERISA 404(a)(1)(D) for ensuring that the plan is operated in accordance with the terms of the plan document subject
- to the fulfillment of any responsibilities retained by the employer
- This is an extremely broad responsibility: "operational compliance" is a catch-all term covering nearly everything that can go wrong in a retirement plan
- Includes the many requirements that must be met for a plan to be "qualified" for tax purposes
- Ensure proper documentation and ERISA 107/209 records retention

Plan Document Administration

- Prepare plan document and ensure compliance with applicable laws
- Prepare plan adoption and trust agreements
- Prepare plan qualification package
- Ensure plan document is amended as required by new laws, regulations, and mandatory restatements
- Obtain favorable letters of determination
- Maintain records of historical plan documents

New Hire and Termination Processing

- Identify eligible based on plan provisions and employer-provided data and automatically mail packet to address of record
- Administer auto-enroll provisions
- Complete, up-to-date enrollment materials
- Online enrollment process with live telephone backup

Service Provider Selection and Oversight

- Prudent hiring of service providers not appointed directly by employer such as auditor and custodian
- Review vendor fee disclosures and ensure reasonableness of fees

Participant Notices, Statements and Disclosures

- Preparation of notices and disclosures such as SPD, SMM, SAR, 404(c), QDIA, ACA, Safe Harbor, and 402(f); contrast with how a non-fiduciary TPA provides a
- Boiler plate document the employer is supposed to review and approve
- Ensure document delivery compliant with DOL rules on electronic disclosure
- Includes beneficiaries, alternate payees, and other "interested parties"

Plan Audit

- Select and monitor plan auditor in accordance with joint DOL/AICPA guidelines
- Negotiate volume discounts
- Serve as primary liaison with auditor; remove employer from loop to the maximum extent possible
- Prepare plan financial statements to meet the letter of AICPA independence guidelines
- Obtain and make available an SSAE 16 audit on internal controls to allow for a limited scope audit

Participant Fee Disclosure

- Compliance with DOL Reg. Sec. 2550.404a-5
- Gather fee information from third parties and collate the data to create the plan's disclosure documents
- Ensure timely delivery of disclosures annually and to newly eligible employees in accordance with the DOL's rules on document delivery

Hardship Distributions

- Cross-reference plan document rules since each plan may be different
- Test for both existence and amount of need
- Take only from allowable sources and only after exhausting loans and ISDs
- Suspend deferrals for six months and reinstate promptly when applicable
- Keep careful documentation of every distribution for the ERISA 107 period

Loans and Loan Repayments

- Establish written loan policy as supplement to plan document
- Review and approve loans; remove employer from loop except for payroll deductions
- Ensure amortization periods match actual payroll implementation
- Ensure each loan agreement is executed and documented
- Enforce quarterly deadlines and deemed distribution requirements

Contributions

- Establish and enforce ERISA 402 funding policy for timing of remittances
- Maintain proper source accounts and tax basis
- Ensure proper investment of contributions of "defaulted" participants
- Ensure rollovers into the plan are from qualified sources

Government Filings

- Prepare and submit filings such as Form 5500 Annual Report with applicable Schedules, Form 5558 extensions, Form 5330 prohibited transaction tax reports, PBGC premium filings, and more
- Tax reporting, state and federal, including 1099-R, 1096, 945, and 1099-MISC

Compliance Testing

- Determine plans to include for compliance testing
- 401(a)(4) Nondiscriminatory Allocations
- 401(a)(9) RMD
- 401(a)(26) Minimum Participation testing
- 402(g) Excess Deferrals
- 404 Maximum Deductible Contributions
- 410(b) Minimum Coverage testing
- 414(s) testing for non-safe harbor compensation
- ADP/ACP testing
- 415 Annual Addition testing
- 416 Top Heavy testing
- Nondiscriminatory Benefits/Rights/ Features
- Determine Highly Compensated employees and key employees
- Prepare comprehensive compliance reporting package
- Provide detailed analysis of testing results
- Develop corrective scenarios in the event of test failures

Plan Operational Oversight And Compliance

- Review and ensure the qualified status of domestic relations orders (DROs)
- Ensure that alternate payees are given their ERISA participant rights
- Review and approve distributions, including determinations of disability, death, retirement, or other distributable events
- Ensure that the appropriate notices are delivered and that the tax withholding rules are properly applied

Forfeitures and Suspense Accounts

- Ensure that all unallocated monies are used to offset employer contributions, pay plan expenses, or are allocated to participants by plan year end
- Includes revenue sharing held within the plan, monies returned to the plan such as expense reimbursements, forfeitures, demutualization proceeds, legal settlements, etc.

Corrections and E&O

- SCP, VCP, Audit CAP, DFVCP, and VFCP calculations, preparation of government submission, follow-up, and implementation of corrections
- Maintain an E&O account for trusteed plans to ensure an audit trail for corrections
- Maintain insurance and reserves at appropriate levels at or in excess of regulatory requirements

Claims and Benefit Determinations

- Establish and administer ERISA-compliant claims process
- Verify identity of beneficiaries
- Make benefit determinations in accordance with the plan document and ERISA
- Ensure QJSA/QPSA rules are met and proper waivers obtained, including spousal consent on all loans and distributions with respect to protected sources

All Plan Review Process

- Establish plan governance process and checklist
- Provide completed checklist and annual review report annually
- Review service provider performance and fees

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Administration

Action Step:

Determine whether your recordkeeper and/or TPA have assumed responsibility for administrative tasks. If not, you should review your plan document with staff to ensure they are adhering to all provisions.

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Participant Enrollment

Automatic

Default Investment Alternative

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Participant Enrollment

Action Step:

- Look at the savings rate for your participants within every age group and their account balances.
  - Most likely you will find the majority are failing to save enough for retirement.
- Look at your medical claims, worker's comp claims, time off etc… for older staff.
  - Often the older generation cannot afford to retire and hang on to jobs longer and in many cases this reduces effectiveness and increases health care costs.
- Consider Auto-Enrollment at 6%. Opt out rates between 3% - 6% are about 10% nationwide.
- Make sure you have a Qualified Default Investment Alternative and the proper disclosures given to participants.

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Participant Contributions

Automatic

Escalating

Safe Harbor Match (eliminate discrimination testing)

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Participant Outcomes

- " According to Scholz and Seshadri (2009), "typical advice suggests that replacement rates should be 70 to 85 percent of preretirement income."
- Assuming an 80% replacement ratio a participant needs to save at least 10% of their income for every paycheck from their early 20's until normal retirement age. We know most have not done so what should they be saving?
- Participants tend to "Anchor" to the employer match and believe they are saving enough.
- Set it and forget it! How many participants review their contributions and consider an increase each year or even each raise?
- Shouldn't we judge the success of a retirement plan on participant outcomes. Better said…Preparing them to retire when you want the to retire!

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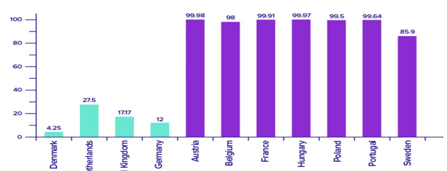
Organ Donation & Behavioral Finance

- The Canadian Transplant Society finds that over 90% of Canadians support organ and tissue donation, but less than 20% have made plans to donate. So, if the public supports organ donation, why are actual donation numbers so low?



Effective consent rates, by country. Explicit consent (opt-in, turquoise) and presumed consent (opt-out, purple).

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Participant Contributions

Action Step:

Request a report from either payroll or your recordkeeper with the number of employees failing to contribute, how many contribute less than the amount you match up to, and how many highly compensated employees were unable to contribute the maximum due to discrimination testing. You could be missing an easy solution that benefits your company.

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Participant Investment Direction

Limits plan sponsor liability if you comply with ERISA 404(c) requirements

There may not be a single recordkeeper that ensures your compliance

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Section 404(c) is an Exception, Not the Rule

"There really is no need for confusion. Rule 10, section 5, article a, subsection 3, exception 4 quite clearly states ... "

- The general rule is that ERISA plan fiduciaries are liable for all aspects of selection and monitoring of plan investments and are on the hook for any participant claims for fiduciary breaches should something go wrong.
- If the ERISA plan satisfies 404(c), fiduciaries would NOT be liable for any claim of a breach related to a participant's selection of investments.
- Since this is an exception, and not a rule, plan fiduciaries remain liable for the selection and monitoring of all investment options made available to the participant.

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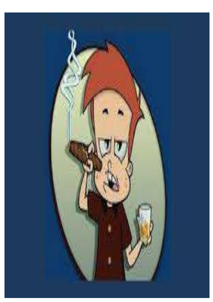
Big Johnny

- Being the "Wise Fool" Big Johnny is going to chase the highest return possible for his 401(k) account
- Sees the "Real Estate Fund" made a 32% return last year and that was higher than any other option so he moves his whole balance of $100k into the fund.
- Interest rates start to rise and he loses 10% because he isn't aware of the correlation. Now $90k
- He thinks to himself it returned 32% last year it will probably come back. Interest rates continue to rise, the real estate market contracts further and the fund loses 25%. Now $67,500



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What Does Big Johnny Do?

- He is desperate to make up for his losses. Sees the Financial Sector fund made the highest return and moves his balance of $67,500 to that fund.
- Interest rate start to ease and the financial fund loses 20%, Now $54,000
- GRRRR! #&@&%*! Who can I blame?
- If the plan sponsor followed 404(c) properly then Big Johnny may not have any recourse other than to blame himself.
- EXCEPT
- The plan sponsor must have had a prudent, documented process on why specialty funds were allowed as investment choices.

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Participant Investment Direction

Action Step:

Ask for a report that documents your compliance with the entire ERISA Section 404(c).

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Participant Advice is Different Than Participant Education

Can be provided without increasing plan sponsor's liability

Can only be provided by firms compliant with 2006 Pension Protection Act (PPA) – Qualified Fiduciary Advisor (QFA) provisions

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Participant Advice

Action Step:

- If you have a broker, advisor or recordkeeper offering participant advice, ask them for proof of their independent audit and certification that they are compliant with these provisions.
  - Are they CEFEX certified?

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Step 2 - Implement a Sound Risk Management Process

Process, process, process.

You can be judged by the government based solely upon your process. You can be judged by litigators based upon both process and results. The good news is results are the byproduct of a sound risk management process. If you comply with the seven-step process outlined here you should be able to demonstrate your actions are compliant with the Prudent Man Standard of Care. Let's identify the components of a sound process and dig a little deeper into each.

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Step 2 - Implement a Sound Risk Management Process

1. Committee Bylaws
2. Fiduciary Training
3. Investment Policy Statement
4. Meeting Minutes
5. Reporting
6. Fiduciary Briefcase
7. Fiduciary Insurance

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Committees

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Committee Bylaws

Identify Committee Members	Identify Committee Duties
Identify Frequency of Meetings	Identify Attendance Requirements

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Committee Bylaws

Action Step:

Read your plan's bylaws to ensure these topics are addressed. If you have no bylaws, this should be the number one topic on your next meeting agenda.

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Fiduciary Training

Flexible

Informative

Meets DOL Expectations

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Fiduciary Training

Action Step:

Determine what you would show the DOL under audit to prove your committee members understand their duties and responsibilities. How will you prove they have been properly trained?

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Investment Policy Statement

Identify criteria

Identify monitoring process

Identity decision process

Follow what you put in writing

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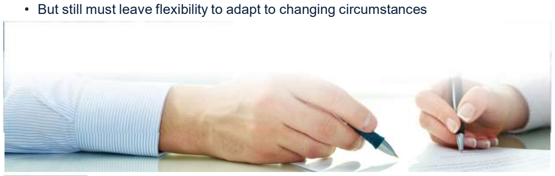
Investment Policy Statement

- Upon audit the government may ask you to explain your investment policy. This would be much easier to communicate if you had an investment policy statement that was in writing.
- Absent a written document it would be difficult at best to ensure consistent adherence to your stated policy.
- You should identify the criteria used for investment selection, the process used for monitoring and watching adherence to your criteria, as well as the basis for fund replacement decisions.
  - Structure for your investment process
  - But still must leave flexibility to adapt to changing circumstances



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Investment Policy Statement

Action Step:

Read your current investment policy statement. Are you following what is written? Can you adapt to changing times? Can you identify the criteria, monitoring and replacement decision process? Would you be able to defend your documented decisions are compliant with your investment policy statement?

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Meeting Minutes

- Identify Attendees
- Describe Issues Discussed
- Describe Decisions Made
- Describe Actions to be Taken

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Meeting Minutes

Action Step:

Carefully read your meeting minutes to ensure they are documenting all activity taking place. If you have no meeting minutes, this should be discussed and addressed at your next committee meeting.

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Reporting

- **Quarterly Investment Management**
- **Annual Fiduciary Review**
- **Annual Fee Review**
- **Annual Plan Demographic Review**

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Reporting

Action Step:

Examine one year's worth of reports and read them all. Conclude for yourself whether they are telling the story of a sound fiduciary process. Now have a co-worker with zero involvement on your committee do the same. Ask that co-worker the following questions – What is this plan costing our participants? What investment options failed enough criteria to be on our watch list during the year? What percentage of our participant population is not saving enough? What steps did we take during the year to ensure we followed a sound fiduciary process? Anyone who reads your reports should be able to answer those questions.

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Fiduciary Briefcase

Retain all documentation to prove process

Respond timely to government audits

Provide auditor access for annual audits

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Fiduciary Briefcase

Action Step:

Do you have all plan documents, vendor contracts, reporting, meeting minutes, fidelity bonds, bylaws, IPS, etc., in PDF format readily available at a moment's notice? If not you should consider working on that project before you are forced into a fire drill.

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Fiduciary Insurance

- **Insurance coverage beyond a fidelity bond**
- **Protects committee members from breach of fiduciary responsibility claims**
- **Can also cover intentional acts of malfeasance**

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Fiduciary Insurance

Action Step:

Find out whether you are covered.

Period.

If not get covered.

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Learn the Two-Step Tango

1. Take advantage of ERISA safe harbors
2. Implement a sound risk management process

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Learn the Two-Step Tango

The government has indicated through various Code Sections of ERISA how you can hire experts and transfer responsibility to them as plan fiduciaries. Whether or not you hire experts & fiduciaries the expectation remains that you manage your retirement plan as a prudent person would in similar circumstances. Go back to your office and follow through on the call to actions. The two step tango can assist you with implementing a sound fiduciary process!

Thank you for attending and if you have any questions about these steps, please contact your plan advisor.

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