Fiduciary Diligence, Best Practices, Lawsuits and Lessons Learned

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Melanie Walker

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Fiduciary Best Practices

- Sources of Fiduciary Responsibilities in Governmental Plans
  - United States Constitution contracts clause (“No state shall …pass any … law impairing the obligation of contracts …”)
  - Internal Revenue Code §401(a)(2) and §457(g)(1) exclusive benefit rules
  - State statutes and municipal codes on plan authorization, ethics and conflicts of interest
  - Common law of trusts and applicable court decisions
- ERISA codifies part of the common law of trusts
  - Governmental plans often use ERISA as guidance even though not subject to its specific rules

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Fiduciary Best Practices

Under ERISA §404(a)(1), affirmative fiduciary duties are:

- Act prudently with respect to plan assets and expenses
- Diversify assets (investment options) to minimize risk of losses
- Loyalty to the beneficiaries of the trust
- Act solely in the interest of such beneficiaries for the exclusive purpose of providing plan benefits and paying reasonable expenses
- Comply with plan provisions and applicable laws

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Fiduciary Best Practices

Examples of ERISA rules that provide guidance to public plans:

- ERISA §408(b)(2) provider compensation disclosure rules require that plan sponsors obtain from service providers:
  - Written description of services to be provided
  - Information on whether such services are provided in a fiduciary capacity
  - Description of all direct and indirect compensation received by the provider

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Fiduciary Best Practices

Examples of ERISA rules that provide guidance to public plans:

- ERISA §404(c) participant fee disclosure regulations require sponsors to provide specific information about:
  - How to select investments and any limitations on investing
  - Each investment alternative offered, including type or category, historical performance, benchmarks, and website address for more information
  - Fees for investment management, plan administration and individual transactions

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Fiduciary Best Practices

Fiduciary duties under the common law of trusts:

1) Prudence
   - Prudent expert rule
   - Modern portfolio theory
2) Loyalty
   - Requires trustees act solely for the benefit of beneficiaries of a trust in all decisions
   - Avoiding conflicts of interest can be difficult for trustees balancing multiple interests when making policy decisions
   - Conflicts can be mitigated by governance policies and diligent oversight

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Fiduciary Best Practices

- Good governance can mitigate conflicts of interest and risk to the plan, including financial, reputational and operational risks
- Common plan policies that address fiduciary duties include:
  - Governance policies that define the roles and responsibilities of fiduciaries, administrators and advisors
  - Investment policies that address investments, fees and other critical information to participants
  - Ethics policies and conflicts of interest rules that are consistent with applicable law
  - Procurement rules for selecting, monitoring and compensating providers

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Marla Kreindler

Partner
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Fiduciary Diligence 1 – 2 – 3

1. Get educated

2. Consider your options

3. Apply what you have learned to achieve the best results for your participants

Make no assumptions!

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Step 1: Get educated!

- Know your plan's "fiduciary governance" structure
  - Plan provisions and fiduciary governance structures vary from one plan to another
  - Some plans and trusts are set out in "enabling statutes", others have plan and trust documents
  - Some plans adopt rules and regulations, policies and procedures, authorizing resolutions and/or by-laws or committee charters that apply
  - Familiarize yourself with how your governance structure may dictate what you can do
  - Know if, how and when you can make changes
- Know your plan's "applicable laws"
  - State and local fiduciary and conflicts laws also vary widely
    - Some conflicts laws broadly prohibit conflict of interest transactions, gifts and entertainment (even a cup of coffee!)
  - Often your applicable laws will be in the plan's "enabling statutes" or in the state constitution or in state or local contracting laws or laws applicable to public officials

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Get educated!

✓Use "Procedural Prudence" as a way to learn
- This doctrine asks plan fiduciaries to give "appropriate consideration" to the specific facts and circumstances in the same manner as a prudent expert
  - This is another way of saying: Get educated or get expert advice (or both!)
  - Your current providers and prospects – and other industry resources - can offer educational programs, white papers and information on plan features, investments and industry trends and practices
  - Talk to your peers

✓Fiduciary training is accepted practice, even for those already in the know

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Stay educated!

- Keep up on legislative, regulatory and litigation trends for opportunities and potential risk exposures
  - Recent focus of ERISA litigation includes:
    - Fees and expenses
    - Revenue sharing, “hidden fees” and “float” income
    - Stable value vs. money market funds
    - Conflicts of interest
    - Participant disclosures
    - Failure to conduct RFPs
    - Failure to follow plan governance structure
  - Regulatory proposals are ongoing
    - SEC regulation BI, state fiduciary definitions, DOL fiduciary regulation
  - Legislative initiatives that seek to improve plan design and participant outcomes are on the horizon
    - NAGDCA is active in this area

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Consider your options

- Different record keepers – and even the same record keeper - can offer different options for what you might consider the same type of products and services
  - Recordkeeping platforms might be group annuity or insurance contract and/or administrative service and “mutual fund” platforms
  - Record keepers offer bundled vs. unbundled/“open architecture” options
  - “Proprietary” and “non-proprietary” products are also available
- Participant advice and education is offered in many different ways
  - Investment education vs. individualized advice
  - Seminars, webinars, call center or on line education and advance
  - Managed portfolios vs. managed accounts
  - Opt-in (non-discretionary) vs. discretionary (aka fiduciary vs. non-fiduciary)

Experts can help you navigate across different provider products and services

- RFPs are a tool to help your better understand (and leverage) your options

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Consider your options (more examples):

- Contracts can help create better standards
  - When needed to even the playing field, providers can agree to treat you "as though" ERISA applies
  - Institutional plans often use their own "standard" investment management agreements
- The same investment strategy may be offered by the same provider in different ways.
  - Examples may include: An insurance contract, a mutual fund, a collective investment trust and/or a separately managed account.
  - Each product type can offer pros and cons
  - Key terms can vary from one provider to the next
  - Revenue sharing may be "optional" & different share "classes" may be available
  - Custom solutions may also be available

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What else can I ask?

- Ask for disclosure of all direct and indirect compensation that is paid to your contractors and their "agents" or "subcontractors"
  - Follow the money: Understanding provider compensation structures can highlight potential conflicts
  - Is the provider incented to offer managed accounts, proprietary rollover IRAs or other products and services…and is that OK?
- Always review conflicts disclosures
  - Ask for disclosures of conflicts
  - Just because a conflict is disclosed may not mean you have to accept it "as is"
- Understand what standards apply to your contractors
  - Are they a fiduciary or "agent"
    - *Know what it means to be a consultant, broker, advisor, record keeper, directed trustee, custodian or securities lending agent?*
    - What is a "gross" negligence standard of care and how does it compare to a fiduciary standard of care?

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Apply what you have learned to achieve the best results for your participants

- Use the RFP process to help achieve your goals
  - Don't be afraid to include new questions
  - For best results: Ask the hard questions and negotiate contract terms before making your final selection.
- Be prudent and look for value and quality of service
- Conduct a gap analysis to ensure objectives are met (including risk management considerations) and all bases are covered
- Review contract terms for consistency with your RFP and what you were sold
  - Look for "exculpations" or "excluded" services and "limitations of liability"
  - When are you required to provide direction or approval?
  - Who takes responsibility for participant communications?

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Make no assumptions!

- Don't assume you can't make changes.
  - Strong governance structures purposefully allow for change over time
  - Most providers proudly offer different options to meet their clients priorities and objectives
  - Legal contracts are often negotiated
- Don't assume nothing changes.
  - Have a process to ask what new products and features are available
- Don't assume you can judge a book by its cover
  - Providers may look similar, but variations in different service offerings can be significant
- Don't assume conflicts can't be addressed
  - For ERISA plans, the U.S. DOL has issued many exemptions after being fully satisfied that conflicts have been addressed following a public comment process

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Do you know?

- 457 plans can choose their funding vehicles
  - Insurance group annuity contract, trust or custody accounts are all options.
  - Would you rather have a trust or custody relationship?
- What is an expense reimbursement account and are other options available for my plan?
- What is "float income"?
- What happens when we can't locate a participant or they don't cash a check?
- What is an independent fiduciary or a co-fiduciary?

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Daniel Alexander

CEO & Managing Director
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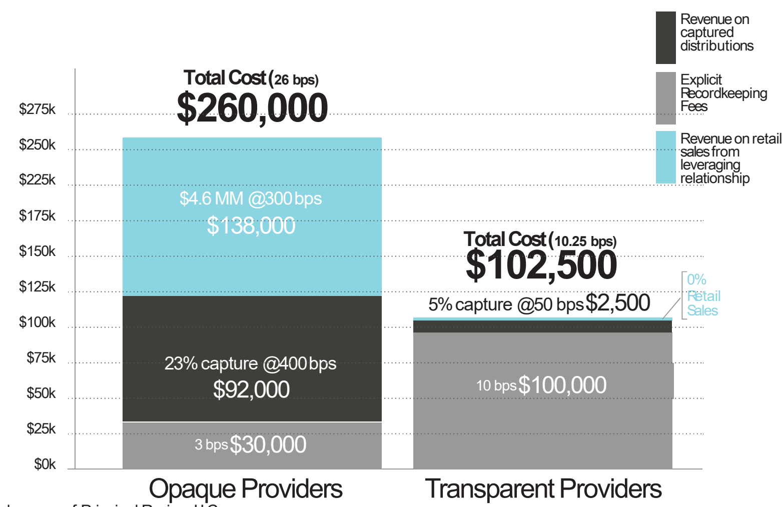
Illustration of Recordkeeper Revenue Strategies



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Top Questions to Ask Recordkeepers

1. How are plan representatives paid? How are they really paid?
2. How's your data being used? Is it shared with affiliates for purposes unrelated to plan administration?
3. Who's talking to your people?
4. What else are they selling?
5. Reasonable compensation: 2 sides to that coin.

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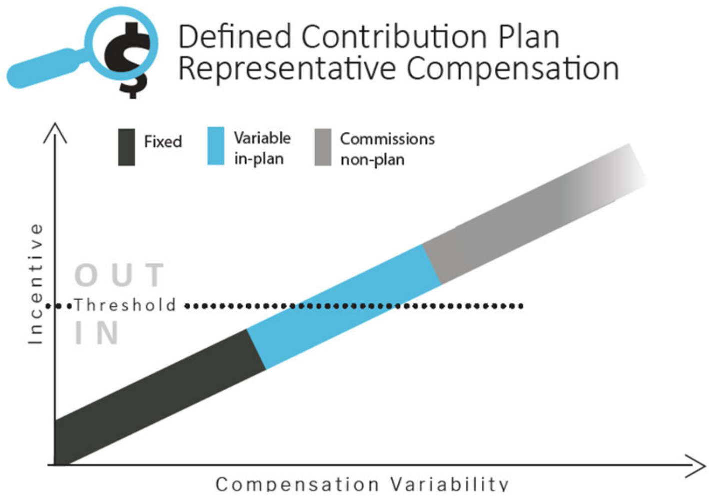
Understanding Plan Provider Representative Compensation



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Top Questions to Ask Yourself/Plan Advisors

1. What price are my participants "paying" for low recordkeeping fees?
2. How much is my plan data worth to providers? Why are we giving this away for the benefit of plan providers?
3. Do I know how much indirect revenue is being generated, by my participants, for my plan recordkeeper(s)?
4. Do my participants believe that we have "endorsed" non-plan products sold by my recordkeeper(s)?
5. Does participant "education" from my recordkeeper(s) provide education or is it a means to an undisclosed end?

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Be mindful of these 3 behaviors…

1. Activities and communications that imply an endorsement of your plan provider(s) services that are unrelated to the contracted services in your recordkeeping agreement.
2. Serving on a recordkeeper's retirement plan council, committee or similar arrangement. Whether it is your current plan provider or a prospective provider, participation in such arrangements may be perceived as a conflict in the provider selection or retention process.
3. Accepting verbal responses or commitments to plan protocols. Likewise, ensure your understanding of written communications with your plan provider.

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Q&A

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