

MANAGING FIDUCIARY RESPONSIBILITIES

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Updated 4-8-08

The fiduciaries' role in the investment process is to manage prudent investment practices. "Fiduciary liability is not determined by investment performance, but rather on whether prudent investment practices were followed."

Retirement/Investment Committee: Three to five people, appointed in writing from cross-functional areas: CFO, HR/Benefits Mgr, Treasurer, etc. Make sure each is aware of his or her fiduciary duty and responsibility. (should meet once a year at the minimum, but recommend quarterly meetings to review Fund Performance Report)

Fidelity Bond: It is an ERISA requirement that every fiduciary or employee who handles plan funds must be bonded for at least 10% of the market value of the plan, with a minimum bond of \$1,000 and a maximum bond of \$500,000. The bond's purpose is to reimburse a plan for losses resulting from dishonest acts. The amount of the plan's bond must be reported on the Form 5500 each year.

Fiduciary Liability Insurance: (Not required by ERISA, but affords important additional protection.) Covers claims incurred as a result of a breach of fiduciary duty under ERISA including prohibited transactions (conflicts of interests, etc.). In order to minimize risk, it is important to use third-party investment managers and administrators.

Prohibited Transactions: Fiduciaries must act exclusively in the interests of plan participants. Certain transactions are prohibited and, under ERISA, are a breach of fiduciary duty. One of the most common prohibited transactions involves the timely deposit of Employee salary deferrals. (Deferrals must be deposited as soon as possible, but in no event later than 15 business days after the end of the month in which they were withheld from participant paychecks or it is considered a prohibited loan from the plan to the employer). Other prohibited transactions cover self-dealing; conflicts of interest; kickbacks; investment in employer securities beyond the legal limit; transfer or use of plan assets; direct or indirect sale, exchange or lease of property; and extension of credit.

Any fiduciary who engages in a prohibited transaction is personally liable for any losses to the plan. A penalty tax of 15% is imposed for each year or part thereof that the transaction remains uncorrected. (An additional tax equal to 100% of the amount involved is imposed if not timely corrected.)

Investment Policy Statement (IPS): Clarifies plan's long-range investment goals and objectives; provides a framework for evaluating investment performance; ensures continuity in decision making if committee members change; available for participants if investments are questioned, therefore, must be simple to understand.

Investment Management: ERISA prudent expert rule; select investment options that are prudent and adequately diversified; establish a process for monitoring the investment options; be prepared to replace poor performing or inappropriate fund options if necessary; ensure that fees and expenses are reasonable.

Common Mistakes: Too little focus on risk-adjusted performance, redundant investment options, fund menu gaps (inadequate fund category representation), selecting funds that don't stick to their stated objectives (style drift).

Evaluating Mutual Funds:

- 1) How well has the fund performed within its peer group on a risk-adjusted basis (Sharpe Ratio/Morningstar Ratings)?
- 2) How well has the fund performed relative to its benchmark, appropriate index and IPS objectives?
- 3) How consistent is the fund's investment style?

- 4) How consistent is the fund's performance?
- 5) How expensive is the fund relative to similar funds (fund expense ratios and wrap fees if applicable)?
- 6) Is the fund itself sufficiently diversified?
- 7) Does the fund provide additional diversification opportunity when combined with other core funds?

Participant Communication/Education: (ERISA 404(c) compliance), free access to information (meetings, Internet, printed material such as newsletters), ongoing education such as sessions on specific investment topics, on-site workshops, Web-based self-help tools and calculators, (very few companies offer any outside investment advisory services due to the cost, additional fiduciary responsibilities and due diligence required.)

Disclosure/ERISA Reporting: 404(c) disclosures, Summary Plan Description (SPD), Summary of Material Modifications (SMM), Summary Annual Report (SAR), Form 5500/Annual Return/Report of Employee Benefit Plan and Audit (if applicable), Distribution options – IRS Special Tax Notice.

Due Diligence Review and Process: Investment performance, service provider performance, plan design features, plan fees and expenses (clear understanding/full disclosure/consistent with contracts/finders fees and 12b-1 fees appropriately applied & documented if applicable).

Due diligence file:

- 1) Investment Policy Statement
- 2) Retirement Committee written quarterly meeting minutes
- 3) All Plan documents (Basic Plan Document, Adoption Agreement including any amendments, Custodial Service Agreements, Summary Plan Description, Board Resolutions, TPA or ERISA attorney engagement letters)
- 4) Trust/Custodian Reports (including loan activity report if applicable)
- 5) Insurance/bonding policies
- 6) Quarterly Fund Performance Reports
- 7) Dated attendance rosters from employee enrollment and ongoing education meetings
- 8) Competitive RFP's (Requests for Proposal)
- 9) Form 5500's including schedules, SAR's, (Summary Annual Reports), SMM's (Summary of Material Modifications), independent accountant's audit report (required if over 100 participants)
- 10) Fund information (mutual funds' prospectuses; fund fact sheets)
- 11) Participant inquiry requests

Expenses chargeable to a plan: Computation of amount necessary for a plan-to-plan transfer of assets, amendments to comply with tax law changes, routine nondiscrimination testing, obtaining an IRS determination letter, outsourcing costs attributable to plan administration and communication costs.

Expenses not chargeable to a plan: Design studies; amendments to effectuate corporate transactions; costs attributable to negotiations with unions; projected cost studies for new benefits design; amendments to establish early retirement windows; amendments to establish a loan program; consulting fees to review ways to comply with law changes; a portion of a communications booklet describing all the company's benefits.

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