

April 29, 2009

Fiduciary Corner

by James R Sotell, AIF®

The recent market volatility has affected 401(k) plans, and they are caught in the crossfire today incurring even greater scrutiny.



The pinnacle of this scrutiny, from a media perspective, was the recent 60 Minutes lead story, "Retirement Dreams Disappear with 401(k)s." As we all well know, many Americans watch 60 Minutes and reporter, Steve Kroft, is a gifted journalist. He was able to present a compelling case that 401(k)s are fraught with high fees and lack of oversight. The result being Americans will not be able to retire or are having their lifestyles changed forever.

Therefore, the question for us is, **"How does that impact me, a Plan Sponsor, with oversight of our 401(k) Plan?"**

First, it brings to light that litigators (attorneys) were watching this story and saying to themselves, "Is this a case where someone can be sued, e.g. Plan Sponsors for lack of 401(k) oversight."

As a backdrop of what may lie ahead, let us revisit the 401(k) ERISA class action lawsuits that are currently in our court systems. Many of us recall the multiple lawsuits^[1] about excessive fees that occurred in 2006. **So, where do those retirement plans lawsuits stand today?**

Two cases were recently decided in favor of the plan sponsor/fiduciaries. Those cases were *Hecker v Deere & Company* (7th Circuit Feb. 12, 2009) and *Kanawi v Bechtel Corp* (Nov 2008). **In the Deere Case, the Court decided that disclosure of total fees to participants was done.** The breakout of revenue sharing was not necessary under current law. As we know, Congress is pursuing greater disclosure^[2] for participants and this may lead to disclosure of revenue sharing in the future.

The court, under the *Bechtel* case focused on the question, "Did the fiduciaries follow procedural prudence in fund selection and monitoring of plan investments?" **The court findings were yes, the Plan**

Sponsor/Fiduciaries met their responsibilities and the key was their ability to prove it through documenting the process. The court held that "The test of prudence is one of conduct not performance."

What these cases underscore is that Plan Sponsors need to have a thorough fiduciary process. The challenge for many Plan Sponsors is they lack the time or expertise in fulfilling these requirements. One recent study[3] showed:

- Only 58% of Plan Sponsors kept Meeting Minutes
- Only 27% used a third party to analyze fees

These results show that litigators probably have strong odds of finding a Plan Sponsor/Fiduciary that lacks the procedural prudence to prove they have a process that has been followed and well documented.

Therefore, what should a Plan Sponsor do to ensure procedural prudence. The first question a Plan Sponsor should ask is "**Who is assisting/supporting me with my fiduciary decisions?**"

If the answer is my financial advisor/broker or provider than you may have a false sense of security. Most brokers/advisors/providers are not fiduciaries for fund selection and monitoring. Some key items to address are (1) make sure your advisor has a written agreement with you and specifies they are a fiduciary in writing, (2) all fees must be fully disclosed, and (3) if the advisor is getting paid by the funds make sure there are no conflicts of interest (the Plan Sponsor will be held accountable too and could incur a possible *prohibitive* transaction).

What should your Retirement Committee or a competent independent third party consultant be doing for procedural prudence to ensure a best practice process:

1. Have a process - Written Investment Policy Statement (IPS)

- many Plan Sponsors have an IPS, but they may incur greater risk than those without if the IPS is not being followed. Some questions to ask:

- *When was the last time you reviewed your IPS?* You should review your IPS annually and note that review in your Meeting Minutes.
- *Are we monitoring the funds tied to the IPS standards?* We see many Plans review fund performance but are not checking how

the performance or other factors relate to the IPS criteria. For example, the fund has a new manager and IPS states manager tenure should be 3 years. Is that being addressed or documented in meeting minutes?

2. Document that process - Meeting Minutes - Many Sponsors may meet but questions to ask about your Meeting Minutes are:

- *What is contained in those Meeting Minutes?* We have seen situations where the Meeting Minutes are very vague and do not provide any level of detail or explanation of what was reviewed and reasons for decisions rendered on funds or other issues.
- *How long are you maintaining those minutes?* Meeting Minutes should be maintained for 7 years as defined under ERISA.
- *Is there any additional backup besides those minutes to support decisions?*

We believe that the investment analysis (e.g. fund attribution data analysis, fund performance vs. benchmarks) should be maintained (electronic version is acceptable) for 7 years.

3. Review the Fees- this includes revenue sharing of funds (amount being paid to advisor, Record keeper, Trustee or other parties) - A Plan Sponsor should, at a minimum, review the total costs of each fund vs. average fund expenses. In addition, review what administrative fees are being charged. If possible, break out those costs by participant paid expenses vs. company paid expenses. Some questions you should ask:

- *Can you provide me (Record keeper, Trustee, Advisor, if applicable) your compensation both as a percent of assets and dollar amount. How was that compensation derived?*

The stakes are getting greater with the 401(k) being the primary retirement vehicle for many of your employees. Therefore, having a solid fiduciary process has never been more critical both for the health of your plan and for the protection of Plan Sponsors.

Although Fiduciary practices can be self-structured, many Plan Sponsors have decided to hire a third-party advisor to ensure that they are meeting the necessary Fiduciary criteria. The days of relying on a third party who is commission-based (either a broker or advisor) are out of date. Sponsors need full disclosure, unbiased advice and fund selected based on prudent criteria and

not driven by the advisor's commissions. Therefore, many Plan Sponsors are moving away from service providers and advisors who have inherent conflicts of interest for the support or perceived advice they provide Plan Sponsors. Rather, many Plan Sponsors have made the decision to hire a truly independent fiduciary consultant who can provide unbiased advice. This ensures that both the Sponsor and Consultant's interests are fully aligned with ensuring procedural prudence and decisions in the participant's best interest.

[1] Issued by Schlichter, Bogard & Denton, a St. Louis firm against over 10 large plan sponsors paying excessive fees, not disclose revenue sharing and lack of fiduciary oversight.

[2] 401(k) Fair disclosure for Retirement Security Act of 2009 being proposed by Committee Chairman George Miller.

[3] Retirement Plan Survey 2009 by Grant Thornton, survey of 270 Plan Sponsors.