International Society of Certified Employee Benefit Specialist Benefits Day

Retirement 101
Fiduciary Responsibilities, Investment Best Practices and Fee Philosophy

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Retirement Plans

Most Commonly Offered

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Types of Retirement Plans

IRA Based Plans

- Payroll Deducted IRA
- SEP IRA
- SIMPLE IRA

Qualified Plans

- Defined Contribution Plans
  - 401(k)
  - 403(b)
  - Profit Sharing
- Defined Benefit Plans

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IRA-Based Plan

- **Payroll Deduction IRA**
  - Easiest to administer
  - No formal plan adopted
  - Employee Contributions Only
  - Contributions limited to IRA maximum
  - Employee deducts under general IRA rules
  - Employer treats contributions as regular pay
- **SEP IRA**
  - Any size employer can adopt
  - Employer contributions only
  - Eligible employee
    - At least age 21
    - Employed 3 of last five years
    - Earned $650
- **Simple IRA**
  - Employer with 100 or fewer employees
  - Employer and employee contributions
  - $5,000 in comp prior 2 years, expected to earn $5000 current year

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Qualified Plans – Defined Contribution

- **Participation in the Plan**
  - Age 21 & 1000 hours
  - 403(b) Universal Eligibility – Employee Contributions
    - Can exclude those reasonable expected to work less than 20 hours per week
    - Entry Date
- **Contributions**
  - Employee & Employer Contributions Allowed
  - Deferrals can be Pre-Tax or ROTH
- **Distributions from the Plan**
  - Retirement
  - Separation of Service
  - In-Service may be allowed
- **Loans & Hardship Withdrawals**
  - May be allowed
- **Vesting**
  - Graded – Up to 6 years
  - Cliff – Up to 3 years
- **Filing requirements**
  - Annual 5500 filing

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Fiduciary Responsibilities Overview

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Fiduciary Steward Responsibilities

Act only for the benefit of participants/beneficiaries exclusive purpose rule (duty of loyalty)

Follow the terms of the plan

Perform duties with the care, skill, and diligence of a subject matter expert prudent person standard (duty of care)

Monitor other fiduciaries and service providers

Diversify plan assets to minimize the risk of large losses*

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Pay only necessary and reasonable plan expenses

Using diversification as part of your investment strategy neither assures nor guarantees better performance and cannot protect against loss of principal due to changing market conditions.

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Determining Fiduciary Status

Remember: the determination of fiduciary status has nothing to do with an individual's title; instead the determination deals with the individual's functional control and authority over the plan. This determination is extremely fact sensitive.

Fiduciary Functions

- Drafting amendment to maintain plan's tax-qualified status
- Ongoing plan administration, such as nondiscrimination testing
- Appointing other plan fiduciaries
- Selecting/monitoring third-party service providers
- Selecting/monitoring plan investments
- Interpreting plan provisions
- Using discretion in approving/denying claims for benefits

Settlor Functions

- Plan design or discretionary plan amendments
- Deciding to establish or terminate a plan
- Deciding to merge plans or transfer assets
- Determining liabilities and expenses for employer's financial accounting
- Union negotiation
- Internal business decisions

Just because an individual is a plan fiduciary for one purpose does not mean that he is a fiduciary with regard to all functions performed for the plan. Additionally, you may have fiduciaries beyond the committee.

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Plan Governance Process

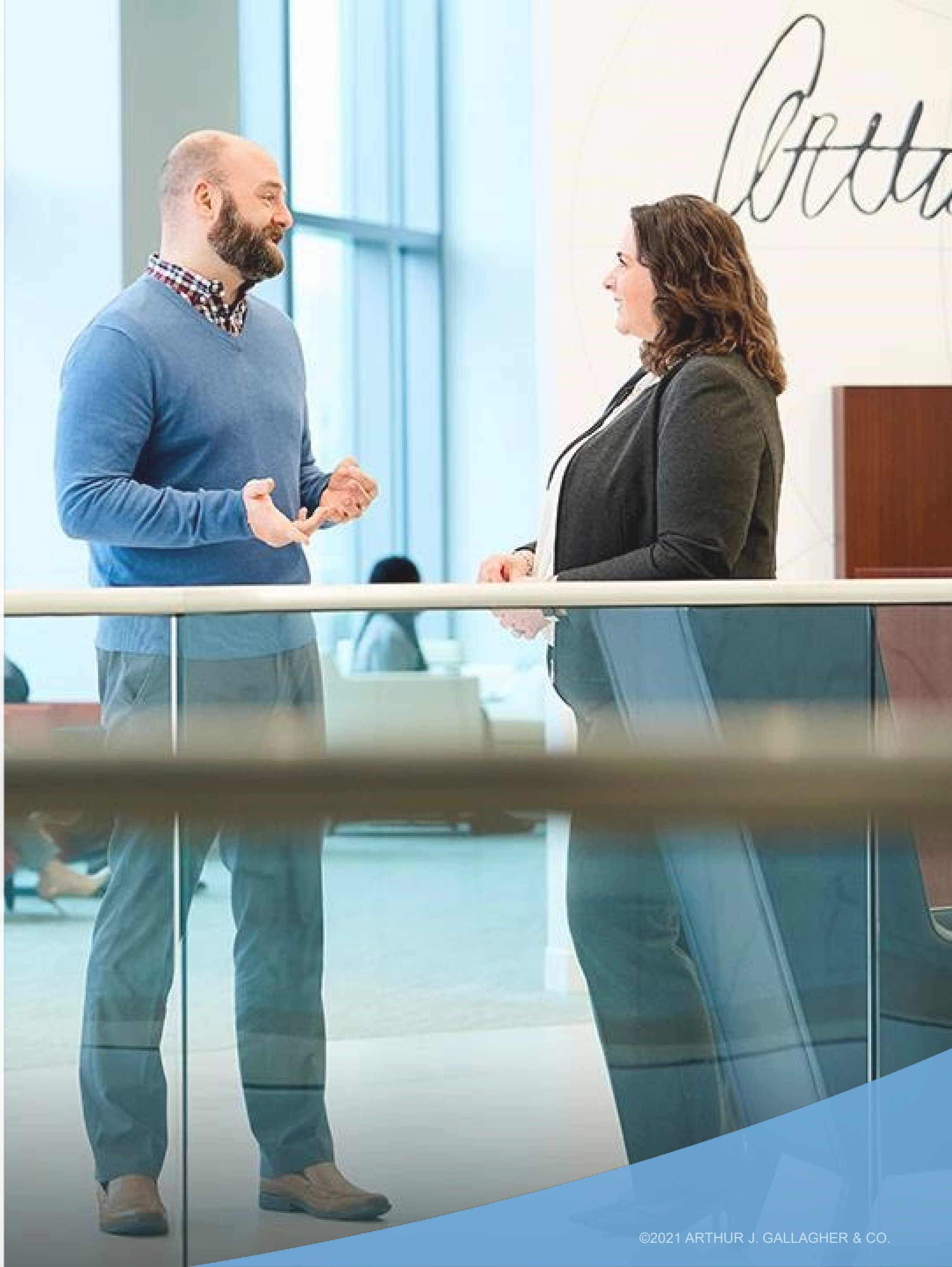
Fiduciary Risk Mitigation Best Practices

A well-designed and executed governance structure can:

- Reduce fiduciary risk by establishing rules and processes for plan decision making; and
- Assist plan Committee members in making educated decisions in an efficient manner.

Meet the objectives of the retirement plan by:

- Creating ongoing continuing education for committee members;
- Promoting positive outcomes and increasing retirement readiness; and
- Documenting all investment related decisions.



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Investment Best Practices

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Best practices for plan investment fiduciaries should center around:

1. Maintaining and adhering to the **Investment Policy Statement**;
2. Meeting **ERISA §404(c)** requirements when constructing the investment array;
3. Selecting a default investment that qualifies as **a Qualified Default Investment Alternative (QDIA)**;
4. Avoiding **proprietary fund requirements** where possible;
5. Demanding **fee transparency** and reviewing fees on a regular basis for investment, vendor and consultant fee reasonableness; and
6. Constructing an **investment menu/line-up appropriate to the skill level** of plan participants.

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Investment Policy Statement

What is it?

- **No specific requirement in ERISA** that an Investment Policy Statement (IPS) be implemented.
- With or without a written IPS, plan fiduciaries are subject to requirements of procedural prudence.
- According to the DOL, the Investment Policy Statement (IPS) is a statement that provides fiduciaries who are responsible for plan investments with guidelines or general instructions concerning various types or categories of investment management decisions.
- Its purpose is to **formally outline the process** fiduciaries follow during the investment decision making process related to a plan's goals and objectives.
- **By adopting and following an IPS, plan fiduciaries are better positioned to establish that they did what the law requires.**

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Investment ERISA Safe Harbors

What type of Safe Harbors are there?

ERISA Section 404(c)

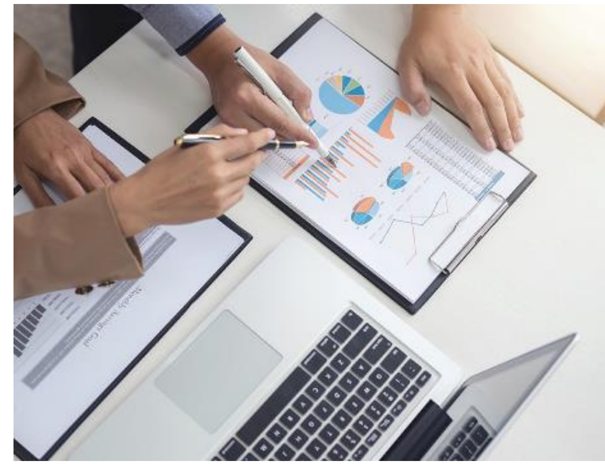
The first safe harbor created was under ERISA §404(c). If the numerous requirements of §404(c) are satisfied, plan fiduciaries may avoid liability for investment losses within individual accounts.

Qualified Default Investment Alternative (QDIA)

Individual account plans that use a "QDIA" for default investments can provide protection to the plan's fiduciaries against losses within the QDIA.

Qualified Change in Investment Options (QCIO)

There may come a time when plan fiduciaries decide to make a change to one or more investment options in their retirement plan. These changes should adhere to certain standards in order to be a QCIO. If the change constitutes a qualified change in investment options (QCIO), fiduciaries may receive protection under ERISA §404(c) for the mapping of assets.



The Department of Labor created certain safe harbors that, if used, provide fiduciaries with relief from potential liability.

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Fee Philosophy

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Fee Overview

Reasonableness of Plan Fees

Identify **all** components of plan fees

Understand breadth, depth and quality of services

Compare cost versus services

The Employee Retirement Income Security Act (ERISA) **requires** fiduciaries to make sure they pay only reasonable expenses to service providers and fund managers; but, the Department of Labor (DOL) does not provide a specific definition of the term “reasonable”.

Guidance from the DOL’s booklet on 401(k) Plan Fees: **"don’t consider fees in a vacuum. They are only one part of the bigger picture including investment risk and returns and the extent and quality of services provided."**

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Components of Plan Fees

Investment Fees

The **Investment Fees** is the associated cost of having assets professionally managed. The fee compensates professional money managers to select specific securities for the fund's portfolio and manage based on the fund's investment objective. Fees are generally assessed as a percentage of plan assets.

Covered Service Provider Fees

The **Covered Service Provider Fee** is the fee for administering and servicing the Plan from a plan provider. This may include custody fees, recordkeeping, technology services, compliance services, communications services, accounting, legal and trustee services.

Advisor/ Consultant Fees

The **Advisor/Consultant Fee** is the fee for engaging an independent third party to provide a wide variety of services to help the plan sponsor mitigate their fiduciary responsibility and increase participant outcomes.

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Components of Plan Fees

Investment Fees

- ❑ **Disclosed:**
  - Plan 408(b)(2) & Participant 404(a)(5) Fee Disclosure
- ❑ **Reviewed for reasonableness:**
  - Investment Monitoring Report
  - Plan Fee Analysis
  - Fiduciary Benchmarks Report

Covered Service Provider Fees

- ❑ **Disclosed:**
  - Plan 408(b)(2) Fee Disclosure
- ❑ **Reviewed for reasonableness**
  - Fiduciary Benchmarks Report
  - Plan Fee Analysis
  - Request for Proposals

Advisor/ Consultant Fees

- ❑ **Disclosed:**
  - Consulting Agreement
  - Annual Compensation Disclosure
- ❑ **Reviewed for reasonableness**
  - Fiduciary Benchmarks Report
  - Plan Fee Analysis

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Components of Plan Fees

Components of investment fees:

- **Investment Management Fees:** A management fee is a charge levied by an investment manager for managing an investment fund. management fee is intended to compensate the managers for their time and expertise for selecting stocks and managing the portfolio.

- **Revenue Sharing:** These fees can include 12b-1 + sub transfer agency fees. A 12b-1 fee is an annual marketing or distribution fee on a mutual fund. Sub transfer agency fees are also another component of operating expenses that can be used to offset the administrative costs of the plan.

The annual 408(b)(2) disclosure from the vendor discloses the split between investment management fee and revenue sharing. How the plan is administered for the use of revenue sharing is dependent per plan.

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Fee Deduction Methods

Fiduciary Responsibility

- As described in Field Assistance Bulletin 2003-3, **the allocation of expenses is a fiduciary act.** Therefore, as a best practice:
  - ✓ Consider the plan's fee allocation methodology.
  - ✓ Exercising prudence in picking a methodology, including consideration of industry practices and standards.
  - ✓ Weigh in on the interests of different classes of participants.
  - ✓ Ensure the allocation method has a reasonable relationship to the services being provided to the participants.
  - ✓ Disclose all fees, including revenue sharing, to participants.
- **No one method of fee deduction is correct.**
  - ✓ Fiduciaries should periodically evaluate their decisions to ensure that they continue to reflect current practice.
  - ✓ A review of fee deduction methods is only applicable if the Plan has a required revenue number with their service provider.

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Fee Deduction Methods

Pro Rata

Pro rata is based on the relationship that their individual account bears to the total Plan assets (i.e. each employee pays the same %). Utilizing a sample required revenue, the cost to the sample participants is shown below:

	Participant Account Balance	Required Revenue % Pro rata	Required Revenue $
Participant 1	$2,500	0.11%	$2.75
Participant 2	$1,200,000	0.11%	$1,320.00
Participant 3	$75,000	0.11%	$82.50

Required Revenue 0.11%

Per Capita

Per capita takes the required recordkeeping fee and allocates the same dollar amount to each participant regardless of participant account balance. Utilizing a sample required revenue, the cost to the sample participants is shown below:

	Participant Account Balance	Required Revenue $	Required Revenue % of Assets
Participant 1	$2,500	$85	3.40%
Participant 2	$1,200,000	$85	0.01%
Participant 3	$75,000	$85	0.11%

Required Revenue $85.00

For both approaches to be based on a uniform basis, the recordkeeper would have to credit back all (100%) of the revenue-sharing received from the funds.

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The enclosed analysis is based on current experience with the vendors and should only serve as a preliminary analysis to select the providers to go out to market with. Actual experience may vary. The services each of the vendors provides should play an important role when making the final decision. The Department of Labor instructs that fees are an important component, but not the only factor in selecting a plan administrator. Plan administration efficiencies, participant education and communication, diversity of investments, and compliance are all issues that must be considered in making a vendor decision.

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