Mitigating Fiduciary Liability for Investment Evaluation & Selection In A Profit Sharing/401(k) Plan

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Fi401k FIDUCIARY INSIGHT

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Fiduciary Insight understands that sponsoring a workplace retirement savings plan is most often done with the best of intentions, yet carries a heavy burden of accountability related to investment selection and monitoring.

Therefore our Fi401k solutions strive to mitigate the employer's ancillary obligations that are imposed by the federal government under the Employee Retirement Income Security Act of 1974 (ERISA) – and diminish any corresponding fiduciary liability. Fiduciary Insight provides retirement plan fiduciaries peace of mind by delivering a suite of investment solutions that are based upon three core principles:

PRUDENCE

Fi401k provides a standardized *Investment Policy Statement* (IPS) which provides a logical framework for determining the permissible investment alternatives that may be offered within a 401(k) retirement savings plan. By adopting the Fi401k IPS, any plan fiduciary can demonstrate their use of a prudent methodology for determining their plan's investment options.

DILIGENCE

Fi401k also provides documented *Investment Selection & Review Procedures* (ISRP) that provides a prudent process by which the plan's designated investment options are consistently monitored, periodically reviewed and occasionally re-evaluated or replaced. By employing the Fi401k ISRP, any plan fiduciary can demonstrate their diligence around the ongoing monitoring of their plan's investment options.

SKILL

Fi401k was founded by retirement services professionals who have over 50 years of combined experience managing investments for workplace retirement savings plans, including professionals who carry the Chartered Financial Analyst (CFA) and Accredited Investment Fiduciary (AIF) credentials.

Fiduciary Issues

Sponsoring a workplace retirement savings plan can be one of the most important benefit programs an employer can offer to their employees, by providing a vehicle for the systematic accumulation of retirement assets. In addition, recent surveys have shown that retirement plans have become the employee's most sought-after benefit program – second only to health insurance.

Although sponsoring a 401(k) plan is often done with the best of intentions, there are certain responsibilities that every employer needs to be aware of and actively manage when doing so. Every employer/sponsor of a 401(k) plan is deemed a fiduciary, under the Employee Retirement Income Security Act of 1974 (ERISA). As a result, the fiduciary responsibilities within a workplace retirement savings plan carry a higher standard of care than other investment programs.

Definition of a Fiduciary

ERISA generally defines a fiduciary as anyone who exercises discretionary authority or control over a plan's management or assets held within the plan, including anyone who provides investment advice to the plan or its agents. For a workplace retirement savings plan – such as a 401(k), the people who fall into this category are most typically employees of the sponsoring employer.

"The key to determining whether an individual or an entity is a fiduciary is whether they are exercising discretion or control over the plan. Attorneys, accountants and actuaries generally are not fiduciaries when acting solely in their professional capacities."

- U.S. Department of Labor

ERISA Deemed Fiduciaries

- Plan Sponsor
- Plan Trustee(s)
- Plan Administrator
- Trust Custodian(s)
- Registered Investment Adviser(s)
- Banks or similar financial institutions
- Insurance companies

A Fiduciary is Anyone Who:

- Exercises discretion or exerts control with respect to the management of the plan or its assets - or disposition of its assets
- Renders investment advice – directly or indirectly – for compensation, who has the authority or responsibility to do so
- Has discretionary authority or responsibility for the routine administration of the plan.

It is generally accepted that the primary roles of a fiduciary are to manage the plan within the rules promulgated under ERISA, and in compliance with the plan's documents and instruments.

Fiduciary Duties

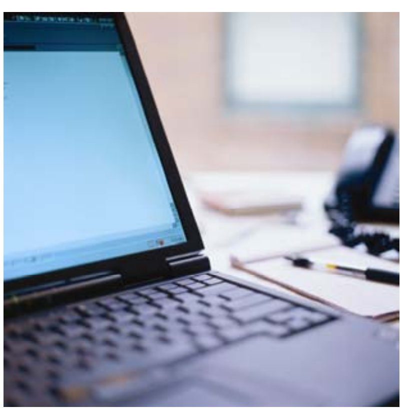
The Employee Retirement Income Security Act of 1974 (ERISA) sets forth five areas of fiduciary responsibility associated with employer-sponsored retirement savings plans:

1. *Duty of Loyalty* – To act solely in the best interests of the plan, its plan participants and their beneficiaries; otherwise known as the exclusive benefits rule.
2. *Duty of Care* – To monitor and defray costs born by the plan, including the reasonableness of the fees paid for benefits delivered – keeping in line with the "exclusive benefits rule".
3. *Duty of Prudence* – To supply a broad range of investment alternatives that enable participants to create an investment portfolio tailored to their personal needs, including the minimization of risk for the potential of large investment losses to the plan.
4. *Duty of Diligence* – To follow the plan documents in the ongoing management of the plan and the benefits afforded therein, including the avoidance of "prohibited transactions" between parties of interest.
5. *Duty of Skill* – To diversify the plan's assets among a variety of investment alternatives and perform periodic reviews of the investment options made available within the plan, by following a prudent documented process.

A prudent fiduciary process should aid in the communication of the plan's policies to participants, as well as protect fiduciaries from making arbitrary or compulsive decisions.

Establishing Prudent Fiduciary Processes

A fiduciary's responsibility does not necessarily require that the plan maintain the highest rated, best performing or lowest cost investment alternatives or service providers. While these may be considerations a fiduciary uses in the management of the plan, it is more important that the fiduciaries define, document and follow prudent processes for their ongoing management of the plan and its assets.



In order to effectively mitigate fiduciary liability, it is necessary to thoughtfully plan, document and follow a prudent decision-making process. A fiduciary can generally meet this requirement, by adhering to the following guidelines:

1. Define the plan's objectives in a written document
2. Provide a mix of investments to achieve adequate diversification
3. Utilize investment managers best suited to the plan's needs
4. Consistently monitor investment characteristics, for changes
5. Record your results and make adjustments, as needed

The Fiduciary Process

ERISA demands that fiduciaries demonstrate their performance consistent with their duties of care and diligence. One such area that this performance is of paramount importance is in the management of the plan's assets and the plan's underlying investment options.

Investment Policy Statement

An Investment Policy Statement (IPS) is a plan instrument that is mandated under ERISA. An IPS is a document that clearly and understandably sets forth the investment goals and objectives of the plan, including the methods used by the plan sponsor and plan trustee(s) in the routine management of the plan's assets. But equally important to having an IPS is using it to guide the decision making process with regard to the investment alternatives utilized by the plan.

An Investment Policy Statement should provide the basic framework under which the plan will operate, with regard to making decision regarding what investment options are to be made available within the plan and for its participants. As a result, it is generally accepted that a plan's IPS should:

1. Set forth the basic objectives for the plan
2. Define the permissible investment vehicles to be used by the plan
3. Describe the investment categories that will be made available within the plan
4. Define the roles and responsibilities of those charged with managing the plan's assets
5. Set forth the investment alternatives selected for the plan

Investment Selection Process

Alongside the construction of an Investment Policy Statement, fiduciaries must also establish the criteria by which they will evaluate and monitor investment alternatives for the plan. Therefore this process should be based upon objectives that are specific, measurable, achievable, results-oriented and time-based (i.e., SMART), and set forth in a written document that is used by fiduciaries and their service providers to effectively manage the plan in conformance with the IPS.

Commonly referred to as the *Investment Selection & Review Procedures (ISRP)*, this document should outline the formal investment decision-making process and provide a framework to assist fiduciaries in objectively evaluating investment alternatives.   Typically, an ISRP document would describe the quantitative and qualitative metrics used to evaluate investment alternatives, both for initial selection and ongoing monitoring.

Ongoing Investment Evaluations

Fiduciaries are required to persistently monitor and review the plans' investment options, based upon the quantitative and qualitative metrics established in the *Investment Selection & Review Procedures*. Thereto, fiduciaries are required to make changes as determined by these periodic reviews, and communicate the reasons for the change as well as the methodology used in determining an applicable replacement investment.

The Prudent Expert

Many small and medium-sized businesses utilize the services of a third-party financial services professional, to assist with the initial adoption of a 401(k) retirement savings plan – including the selection of the investment alternatives made available within the plan. But, in so doing, the majority of business owners rarely understand their fiduciary obligations for the ongoing monitoring and periodic evaluation of those selections.

ERISA requires employer-plan sponsors to select and monitor plan investments in the same manner as persons familiar with generally accepted investment theories and prevailing investment industry practices. But, in the case where the plan fiduciaries lack the necessary technical knowledge to properly perform these duties, they are required "to obtain the advice of a qualified, independent expert." *See DOL Regulation §2509.95-1(c)(6)*

Therefore it is generally accepted that most employer-plan sponsors are better served engaging the services of a professional fiduciary, to assist with or conduct the ongoing due diligence necessary to prudently manage the plan's investment options.

ERISA sets the standard by which all fiduciaries are measured, as being those investment decisions which a like expert, with appropriate knowledge and experience would reasonably make.

Engaging A Professional Fiduciary

Depending upon the type of financial services professional engaged, there may or may not be any fiduciary relief provided under such engagements. Therefore it is imperative that the third-party financial services professional engaged by the plan be able and willing to serve in a fiduciary role.

Thereto, such advisory services may only be provided by a "fiduciary adviser", who is defined as:

1. A registered investment adviser under the Investment Advisers Act of 1940
2. A bank trust department subject to periodic examination and review by regulators
3. An insurance company
4. A person registered as a broker or dealer under the 1934 Securities Act
5. An employee, agent, registered representative or affiliate of any of the preceding parties

Furthermore, the advisory services have to be provided under an "eligible investment advice arrangement" which provides that the fees received by the Fiduciary Adviser do not vary on the basis of which investment options are chosen for inclusion in the plan.

The unfortunate reality is that due to the way most financial services professionals are compensated, they simply do not qualify to perform as "Fiduciary Adviser". So, if a plan fiduciary relies upon a financial services professional who is not qualified to perform as a Fiduciary Adviser, they may inadvertently breach their fiduciary duty – by not being prudent or diligent in relying upon such individuals.

The Fi401k Solutions

Fiduciary Insight has created a web-based service bureau that provides remote investment monitoring, reporting and management services. Our Fi401k solutions strive to mitigate the employer's ancillary obligations imposed by the federal government under ERISA – and diminish any corresponding fiduciary liability.

However, Fiduciary Insight recognizes that not every employer-plan sponsor wants/needs the same level of service for their company's 401(k) plan. So, the Fi401k suite of solutions is designed to meet your specialized needs:

- **Investment Comparison & Optimization (IC&O) -** This service is for plan fiduciaries who are looking to evaluate their plan's current investment options, to determine if they might be able to derive better cost efficiencies and/or access better performing equivalent investment alternatives.
- **Investment Monitoring & Reporting (IM&R)** – This service is for plan fiduciaries who are comfortable with their current retirement plan service provider, and merely wish to augment their plan with robust investment monitoring and reporting solutions.
- **Investment Management & Oversight (IM&O)** – This service is for plan fiduciaries who are desirous of transforming their current plan by adding fiduciary investment management and oversight solutions, which drive cost and performance optimization around their plan's investment options.

Regardless of the Fi401k solution that may suite your specific needs, Fiduciary Insight is committed to assisting employers with establishing a prudent investment evaluation process – by providing every plan sponsor a customized *IPS* and *ISRP* documents.

PROTECTING RETIREMENT PLAN FIDUCIARIES
from INVESTMENT LIABILITY

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