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Fresno County, California
Fiduciary Responsibility

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Agenda

- Fiduciary capacity
- Identifying plan fiduciaries
- Plan fiduciary responsibilities
- Fiduciary best practices
  - Prudent plan administration
  - Prudent investment policies and process
  - Monitoring all aspects of the plan
- Employee communication/education
- Limiting fiduciary liability
- Documentation

Fiduciary responsibility under applicable law

- Fiduciaries held to the highest standard of conduct imposed by law.
- SBJPA imposed exclusive benefit rule and prudence requirements on 457(b) plans.
- Governmental plans are governed by state law.
- State law imposes fiduciary duty through the California Constitution, Government Code, the Uniform Trust Act and the Uniform Prudent Investor Act.
- Failure to meet fiduciary obligations can result in severe penalties, including personal liability.
- Participants continue to sue plan sponsors for alleged breaches of fiduciary duty.

What is fiduciary capacity?

- This question gets right at the heart of what constitutes fiduciary capacity and when it attaches to an individual.
- A person acts in a fiduciary capacity when he or she handles money or property for the benefit of another – here, the plan sponsor handles money for the benefit of plan participants.
- It is precisely because plan assets do not belong to the employer, but rather are held in trust for plan participants, that the plan sponsor has fiduciary responsibility.
- Fiduciary responsibility arises every time the plan sponsor, or certain designated employees, are making decisions that impact the plan and plan assets.

Identify all parties who work on plan.

- List all employees who work on the plan in any capacity.

- List all third parties that assist with the plan, including:
  - Trustee
  - Recordkeeper
  - Consultant or investment adviser,
  - Attorney
  - Other

- Determine which individuals or entities are fiduciaries.

So who is a plan fiduciary?

- Fiduciary status is based on functions performed, not a person's title.

- Anyone who takes discretionary action to manage and administer the plan or exercise control over plan assets.

- A plan's fiduciaries may include the:
  - Trustee,
  - Plan administrator (you the employer),
  - Investment advisors,
  - Members of the plan's administrative committee, and
  - Members of the plan's investment committee.

When is the plan sponsor a fiduciary?

» Employer actions, *not plan fiduciary actions, i*nclude:

- Deciding to offer a retirement plan to employees.
- Establishing the retirement plan.
- Designing the plan’s benefits and features.
- Amending the plan to add or remove optional provisions, such as loans.
- Terminating the plan.

» You are a plan fiduciary, *not acting as the employer*, when:

- Implementing the plan decisions made by the employer.
- Establishing policies and procedures for the plan.
- Administering and operating the plan.
- Keeping the plan document updated for all required changes in law.
- Selecting and monitoring plan’s investment options.
- Selecting and monitoring service providers, consultants and others to assist with the plan.

When are staff members fiduciaries?

- Your staff members *are not* fiduciaries when they:
  - Perform ministerial activities such as processing forms.
  - Act at the direction of participants or plan fiduciaries.
  - Prepare employee communications or answer questions about the plan provisions.
  - Calculate the amount available for a loan or distribution.
  - Perform any other activity not involving the exercise of discretion or authority over the plan or its assets.

- Your staff members *are* fiduciaries when they:
  - Exercise discretion when processing QDROs or other forms.
  - Interpret plan provisions.
  - Perform any other activity involving the exercise of discretion or authority over the plan or its assets.

Are third parties plan fiduciaries?

- Third parties are typically *not* fiduciaries.
- Non-fiduciary experts provide information or act on instructions from plan sponsor or participants and include:
  - Accountants,
  - Actuaries,
  - Attorneys,
  - Auditors,
  - Investment consultants, and
  - Recordkeepers and other service providers.
- Investment advisers are fiduciaries if they provide investment advice for a fee or make decisions on behalf of the plan.

Importance of knowing who is a fiduciary

- » Executives or employees who don't know they are fiduciaries may inadvertently breach their fiduciary duty.
- » Breach of fiduciary duty can result in personal liability.
- » Knowing you are a plan fiduciary will keep you and your plan out of "trouble."
- » Maintaining your participants' trust is extremely important.
- » A sound fiduciary governance process:
  - Protects participants, and
  - Effectively shields the employer, Committee or Council members and other fiduciaries from liability.

Hold regularly scheduled meetings

- Hold committee meetings regularly to discuss and make decisions for the plan.
- Include all plan fiduciaries and any staff or third parties needing to provide information to the committee.
- Key things to document in meeting minutes include:
  - Identity of all persons in attendance.
  - Prominently highlight the prudent process followed at the meeting.
  - Focus on decisions reached at the meeting.
  - Incorporate reports from third-party advisers by reference and maintain as part of the minutes.
  - Emphasize advice provided by third-party advisers and legal counsel.
- Draft the minutes timely and ask all attendees to approve them.

Fiduciary standards of conduct

- California Constitution provides that retirement boards/members of public pension and retirement systems, including 457(b) plans, have a duty to:
  - invest the assets of the plan;
  - administer the plan;
  - act for the exclusive purpose of providing benefits to participants and beneficiaries; and
  - engage in a prudent process for making all decisions related to the operation of the plan, including decisions related to the plan's investments and related services.
- Primary duty = obligation to act for the exclusive purpose of providing retirement benefits to the participants. All other duties must be fulfilled in a manner consistent with providing secure, meaningful, retirement benefits.

Fiduciary standards of conduct

- Subsections (a), (b) and (c) of Article XVI, §17 of the California Constitution contain the provisions governing the fiduciary duties for the administration of public pension and retirement systems.
- Government Code Section 53609 clarifies that 457(b) deferred compensation funds are public pension or retirement funds for the purposes of Section 17 of Article XVI of the Constitution."
- Thus, those administering 457(b) plans are fiduciaries subject to the duties and obligations under Article XVI, §17.
- CA Government Code Section 53609 imposes fiduciary duties virtually identical to those in the Employee Retirement Income Security Act of 1974 (ERISA).
- Where CA legal provisions are not well developed, it is prudent to look to ERISA to develop the fiduciary principals applicable to 457(b) plans.

Fiduciary standards of conduct

- Basic fiduciary principles include:
  - Duty of loyalty,
  - Duty of prudence,
  - Duty to diversify plan assets,
  - Duty to monitor funds and providers and make changes when warranted, and
  - Duty to follow terms of plan documents.

Duty of loyalty

- The duty of loyalty is the exclusive benefit rule:
  - Act solely in the best interests of the plan participants,
  - Act for exclusive purpose of providing plan benefits, and
  - Ensure plan fees and expenses are “reasonable.”
- Fiduciaries cannot put employer interests before those of the plan and participants.
- Avoid conflicts of interest.
- Example.

Duty of prudence

- The duty of prudence focuses on the process followed when making fiduciary decisions.
- Prudence is one of most important duties because it comes into play in every activity undertaken by the fiduciaries.
- Prudence is more than just an obligation to be competent and careful in your conduct.
- Prudence requires fiduciaries to act with the care, prudence, skill and diligence a knowledgeable person administering a retirement plan would use.
- Prudence required the use of good judgment and sound processes when handling the affairs of the plan.

A prudent process

- Prudence a careful, diligent, thorough decision-making process.
- Gathering, examining and giving appropriate consideration to relevant information.
- Implementing the decision.
- Periodically monitoring performance to ensure the decisions continue to be right for the plan,
- Retaining third parties to assist you, if necessary, and
- Keeping good records of your deliberations and decisions.

How to best comply with fiduciary duties when selecting third parties

- Develop a prudent formal process for selecting third parties.
- Use objective criteria in the selection process:
  - Financial condition,
  - Experience,
  - Quality of the services,
  - Any recent litigation or enforcement action, and
  - The proposed fee structure.
- Determine that:
  - Fees paid with plan assets to a third party are reasonable.
  - Third party has no conflicts of interest that could influence his or her recommendations to your plan.
- Document your review process and the basis for your hiring and firing decisions.

Monitoring service providers

- Service providers include trustees, attorneys, consultants, advisers, recordkeepers, etc.
- Establish a process for reviewing each provider’s performance with respect to services set out in the contract.
- Make service provider changes when necessary to promote the best outcomes for participants.
- Keep adequate records of all plan decisions and document the evaluation and decision-making process used in monitoring service providers and the basis for your decision to retain them or make a change.

Prudent investment policies

- State law requires, and courts have agreed, that fiduciaries must adopt prudent investment policies for selecting and monitoring plan investments.
- A prudent investment policy involves developing and following a written Investment Policy Statement (IPS) for the plan.
- An IPS is a written governing plan document outlining the process for making prudent investment-related decisions.
- Courts have also said that fiduciaries must use reasonable diligence in disposing of funds which are improper to keep.
- Your IPS will detail how and when to dispose of funds.

Investment Policy Statement

» IPS should define the duties and responsibilities of all parties involved in the investment process.

» Should establish regular meeting schedule for evaluating the current investment menu and initiating changes when necessary.

» IPS defines your criteria and processes for investment decisions and should set out the:

- Methodology and criteria for selecting a broad, diversified array of investments with different levels of risk and returns.
- Goals, objectives and performance standards the funds are expected to meet to be retained in the investment menu.
- Guidelines for monitoring and evaluating funds, and timing for terminating and replacing any nonperforming funds.

Plan Administration – As important as investment selection!

- » Plan document must comply with all Internal Revenue Code.
- » Plan document must describe each feature you are offering participants – it is your contract with the participants.
- » Read the plan document thoroughly and often and be sure you understand each and every provision.
- » The plan document is your manual for administering the plan.
  - Compare plan policies, procedures and forms to the terms of the document.
  - Revise any procedures that do not exactly match the document.
- » Failure to operate the plan in compliance with governing documents is a top IRS audit "catch-all" and can cause the plan to become ineligible.

Plan Administration – Pay attention to top audit issues

- Trust requirement – know your trustee and maintain signed trust documents.
- FICA tax – paid when deferral is made – not deferred to time of distribution.
- Timely delivery of deferrals into trust – as soon as practicable – IRS rule of thumb.
- Timing of deferrals – first day of month rule.
- Limit deferrals to the 457(e)(15) annual limit, plus age 50 or special catch-up, if applicable.
- Distribute excess deferrals plus earnings as soon as practicable after discovery.

Plan Administration – Pay attention to top audit issues

» Special catch-up contributions:
- Must have underutilized amounts in employer's plan.
- Must establish a normal retirement age that meets the definition in the plan document and that is four years past the first special catch-up contribution year.
- Cannot use special catch-up and age 50 catch-up in the same year – can use whichever is greater.

» Distributions restricted until:
- Severance from employment,
- Attainment of age 70 ½,
- Unforeseeable Emergency, or
- De minimis amount, if allowed by the plan document.

Plan Administration – Pay attention to top audit issues

- Unforeseeable Emergencies:
  - Know the criteria in your plan document and ensure compliance with the final regulations.
  - Acquire, review and maintain copies of the paperwork used to approve the emergency withdrawal.
- Required minimum distributions.
- Loans – coordinate all plan loans and put default procedures in place.
- Auto cash-outs of small balances – if required, must be done timely and consistently with plan document.
- Beneficiary designations and spousal consent – IRS Rev. Rul. 2013-17 now requires plan to treat same-gender spouses exactly as other spouses.

Fiduciary File Cabinet

- Maintain a fiduciary file cabinet to document systematic processes and evidence that good processes were followed.
- Critical components of a fiduciary file cabinet:
  - Identify parties in plan operation and management,
  - Identify what they are responsible for and whether they are a fiduciary,
  - If you use a plan committee, identify who is on the committee, when it meets, what processes it is responsible for and how it implements these processes.
  - Have a definitive agreement to establish roles and liability for third parties heavily involved in plan administration.

Fiduciary File Cabinet

- A complete set of all current signed plan documents:
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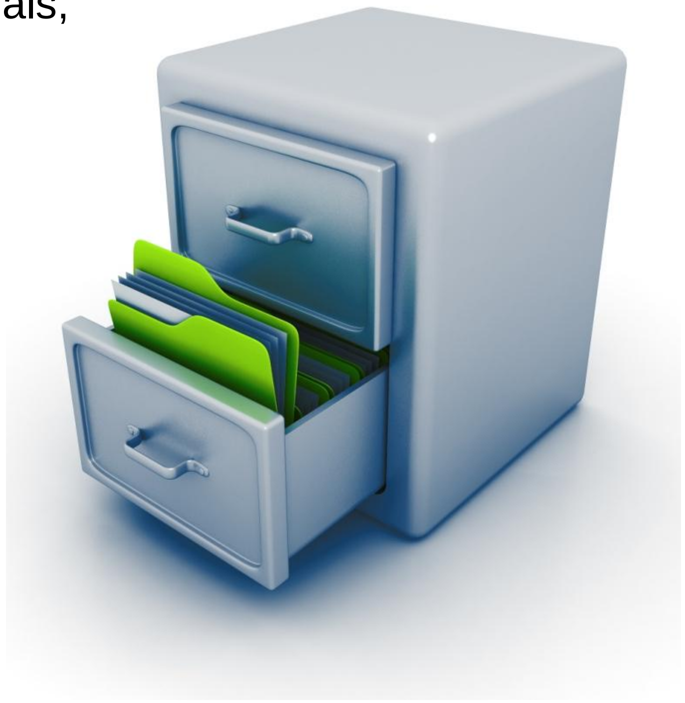
  - Plan documents and any summary plan materials,
  - Trust agreement,
  - Plan forms, rules and procedures,
  - Service agreements,
  - Third party contracts,
  - Investment contracts,
  - Investment Policy Statement, and
  - All amendments to those documents.



Why due diligence matters

- Responsibilities of sponsors of retirement plans are many and not to be taken lightly.
- The IRS is auditing governmental plans.
- Participants have heightened awareness of the importance of their retirement needs and plan investments and fees.
- The number of lawsuits against ERISA plan sponsors is increasing.
- In addition to prudent processes, communicating with and educating participants is a large part of fulfilling your fiduciary responsibilities and limiting liability.
- ERISA 404(c) is extremely important.

Communicate with and educate participants

- Develop easy to understand communications to inform employees about:
  - Key plan features,
  - When participants can request a distribution, and
  - How participating in the plan would benefit them.

- Provide materials and seminars to educate participants about investing and how to manage their account balances.

- Utilize a robust website with retirement income and other calculators to allow participants to make informed choices about contribution levels, investments, etc.

Limiting fiduciary liability by complying with 404(c)

- The California Government Code recognizes that the board may delegate control over the use of the investments to the participants.

- Section 53215.5 of the CA Government Code provides that fiduciaries may avoid liability for potential imprudent investment decisions by the participants only if plan fiduciaries comply with communication and education requirements similar to those prescribed in ERISA 404(c).

- ERISA 404(c) allows plan fiduciaries to avoid liability for individual participant investment decisions – a big deal!

- 404(c) is designed to allow participants:
  - An “opportunity to exercise control” and
  - An opportunity to select from a broad range of investment options.

Limiting fiduciary liability by complying with 404(c)

- Broad range of investment options:
  - At least three options with different risk and return characteristics:
  - Designed to provide participants with a reasonable opportunity to materially affect the potential return and degree of risk in their accounts.

- Once a range of investment options is in place, 404(c) is essentially a communications statute:

- Participant information to assist them to become informed investors:
  - Their right to direct their own investments in the plan,
  - How to make and change investment decisions,
  - The funds and fund managers available under the plan,
  - Investment related fees,
  - Any restrictions on investment transfers, and
  - The name of who to contact for more information.

Limiting fiduciary liability by complying with 404(c)

- Communication materials prepared by you/Great-West are helpful in complying with the automatic disclosure requirements.
- These materials include, among a number of others:
  - Investment Options at a Glance
  - Fund Data Sheets
  - Plan Features and Highlights
  - Quarterly Newsletters enclosed with the participant statements
  - Brochures, articles and video on the website
  - Special mailings, and
  - Seminars to assist with employee education.

Participant Allegations Against Plan Fiduciaries

- Recent lawsuits brought by plan participants against plan sponsors are very instructional.
- At issue in the lawsuits are whether:
  - Plan fiduciaries acted prudently in selecting and monitoring plan investments and compensation arrangements, and
  - Fees were reasonable or excessive, and were properly disclosed.
- Only a few cases have been decided on the merits, some have been settled by mutual agreement of the parties and some have been dismissed.
- Court decisions are based more on the process the fiduciaries used rather than the particular result obtained.

Participant Allegations Against Plan Sponsor - Example

» Plan participants sued the plan sponsor for breach of fiduciary duties to the plan when it:

- Failed to monitor recordkeeping costs and negotiate lower fees to offset revenue sharing amounts paid to the recordkeeper;
- Removed an investment fund and replaced it with other funds in violation of Investment Policy Statement (IPS);
- Selected more expensive share classes when less expensive share classes were available;
- Allowed plan to pay recordkeeper an amount that exceeded market cost of services (and used the excess to subsidize corporate services);

Court Findings

- Plan sponsor's actions were a blatant conflict of interest :
  - Allowing excessive fees to be paid by plan participants to benefit the employer rather than the plan,
  - Failure to follow the IPS, and
  - Altogether failing to monitor the recordkeeper.
- Violated fiduciary's responsibility of prudence.
- Court fined plan sponsor $millions for:
  - Not following prudent processes,
  - Not following the governing plan documents,
  - Not acting when told plan was paying excessive fees, and
  - Inappropriate selection and de-selection of funds.

Limiting fiduciary liability

- On the other hand, courts have found in favor of fiduciaries who:
  - Developed and followed prudent processes
  - Complied with their plan documents, including the IPS,
  - Held regularly scheduled committee meetings, often enough to prudently operate and administer the plan,
  - Documented their prudent actions on behalf of the plan and participants.
- Courts have ruled that following prudent processes is the key!

Summary

- Remember, the ultimate responsibility for the plan and its operations cannot be outsourced or relinquished.
- The key is acting sensibly when making decisions on behalf of the plan.
- Act solely in the best interests of participants which means monitoring fees to ensure the plan fees are reasonable.
- Identify your plan fiduciaries and provide education and training.
- Follow governing documents with respect to selecting and monitoring investment options.
- Follow ERISA 404(c).
- Ensure your policies and procedures and plan operation are in compliance with plan documents.
- Keep records of fiduciary meetings to support decision-making.

Thank you!
Questions?

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