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A Process for Retirement Plan Investment Committees

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INTRODUCTION

Managing an employer-sponsored retirement plan has become an increasingly difficult task for plan sponsors in light of increased scrutiny, the potential for litigation, and the annual audits that many of these plans are subject to. Due to information being easily accessible, plan participants are more educated on retirement plans and plan investments than ever before. As a result, properly administering an employer-sponsored plan and its investment lineup must be done with the utmost care and due diligence to ensure the plan is compliant, as well as to reduce common mistakes, which could lead to potential litigation.

First and foremost, a plan sponsor has a fiduciary duty to its plan participants. As a fiduciary, the plan sponsor is required by law to act in the best interests of plan participants at all times. The plan sponsor, therefore, is held to the highest standards of conduct and care, and must never act to benefit itself above the interests of its plan participants.

As a result, the plan sponsor must have greater knowledge and expertise of plan management than participants; in many cases, this means that the plan sponsor must hire an outside professional who has the necessary knowledge and expertise in order to assist in its fiduciary duties to the plan.

For the purposes of this whitepaper, the discussion on a committee's 'fiduciary duties' referenced above will be focused on a plan's investment lineup, as well as the oversight of experts (investment manager and/or plan administrator) who are hired.

We've outlined, and later expanded upon, 7 critical actions of a committee. These actions will allow a committee to act with the utmost level of care and prudence to the retirement plan(s) that it oversees. These 7 items should be diligently and fully executed in order to reduce risk to the plan fiduciaries and the sponsoring employer.

- Establish an investment committee
- Hire an expert investment manager and/or plan administrator
- Create a charter and conflict of interest document
- Create and follow an Investment Policy Statement
- Log committee meeting minutes and create a fiduciary file
- Receive periodic fiduciary training
- Conduct periodic fee benchmarking

ESTABLISH AN INVESTMENT COMMITTEE

The plan sponsor has the fiduciary duty to manage the plan's investment lineup. This duty includes a number of tasks, such as appropriately diversifying the investment choices available to plan participants and conducting ongoing oversight of an investment manager. This often results in the need to establish a committee.

The committee should ideally be comprised of five individuals; if you wish to have more or fewer individuals involved, be sure to choose an odd number to ensure tie-breaking capabilities during votes.

Committees typically consist of plan trustees, company officers (i.e. VP's or HR representatives), and an employee representative.

The committee should designate a Chairperson and a Secretary. The Chairperson will be responsible for conducting the meetings. The Secretary is responsible for compiling committee agendas and keeping minutes of any decisions made by the committee and is the official custodian of committee records. Either the Chairperson or Secretary will execute all official contracts (as delegated by the committee).

Once the committee members are selected, a regular meeting schedule should be established, typically on a quarterly basis. A majority of committee members should be in attendance in order to conduct business at any committee meeting. The typical responsibilities of a committee include, but are not limited to, the following:

- Prepare, adopt, and maintain an Investment Policy Statement (IPS) for the plan;
- Determine whether the objectives of the IPS are being followed;
- Review the IPS annually;
- Prudently select, appoint, monitor, and evaluate the plan's investment manager;
- Meet with the investment manager on a quarterly, or more frequent, basis to review the investment performance of the plan;
- Review the actions of the investment manager, and evaluate the investment performance and selections of the plan investment fund options.
- On an annual or more frequent basis, evaluate the performance of the investment manager;
- Review the Watch List and any fund replacements;
- Discuss any outstanding fiduciary issues; and
- Receive periodic fiduciary training.

Since most plans hire an investment advisor to manage the investment lineup, committee meetings provide an opportunity to ask the advisor questions such as:

- Why was a fund added to (or removed from) the Watch List?
- Can you explain why Fund X hasn't been performing well?
- How will 'new legislation that was recently passed' impact our plan?
- Are the least expensive share classes that are available being utilized?

As will be discussed later, fiduciary training should be provided to the committee so they fully understand their fiduciary duties. By participating in the committee, all committee members are considered plan fiduciaries. As a result, it is recommended that fiduciary liability insurance be purchased. Fiduciary liability insurance protects an employer, and any employee acting in a fiduciary capacity, against claims resulting from a fiduciary breach in managing the retirement plan. This insurance can be required in the committee charter.

HIRE AN EXPERT INVESTMENT MANAGER AND/OR ADMINISTRATOR

Committee members are typically not experts in operating a retirement plan. Therefore, hiring an outside plan provider who can also act in a fiduciary (or sometimes non-fiduciary) capacity to provide any needed expertise is essential. These experts can help with the day-to-day administration, investment decisions, and/or required communications with employees. They will not only help save time, but can help to avoid some, but not all, fiduciary liability. This is because the plan sponsor and/or committee will still need to appropriately monitor any co-fiduciaries or plan providers that are hired to assist with plan management and administration.

Plan sponsors and/or committees should conduct extensive due diligence to hire the right plan provider(s) to help guide them in making decisions that affect plan participants. Not all co-fiduciaries are the same, however. The differences are important to understand when a plan sponsor considers what is involved in each level of fiduciary service. The most commonly hired co-fiduciary plan providers are 3(38), 3(21), and/or 3(16) fiduciaries. Let's take a look at some of the important differences between them below:

3(38) fiduciary

A 3(38) fiduciary (or investment manager) is an investment fiduciary pursuant to ERISA section 3(38). They are responsible for selecting, managing, monitoring, and benchmarking the investments in the plan's fund lineup. Simply put, they have full discretion to make investment decisions for the plan.

Working with a 3(38) investment manager provides your company with a tremendous value-add, since they are required to look out for the best interests of the plan and plan participants. This is in stark contrast to traditional brokers who can have high fees and are known for recommending funds that can generate higher sales commissions; while these investments may have a suitable customer, chances are good that your company is not that customer, because brokers are held to a suitability standard and not a fiduciary standard.

ERISA and precedents established by the U.S. Department of Labor (DOL) further outline the requirements of a 3(38) advisor as follows:

- Aid in the creation and management of an Investment Policy Statement;
- Assist in the formation of an investment committee;
- Help organize investment committee meetings;
- Select plan investment options that are prudent and beneficial;
- Regularly report on the performance of the plan investments;
- Conduct investment benchmarking on a regular basis; and
- Replace funds and update models, as needed, to ensure compliance with client goals.

3(21) fiduciary

Until recently, the 3(21) fiduciary relationship had been a common arrangement that a plan sponsor or committee would make with an investment manager. A 3(21) fiduciary has similar duties to a plan as a 3(38) fiduciary, such as recommending investments to the plan sponsor or committee, monitoring those investments, and suggesting replacements. They also provide participant education, including advice, and can create an IPS. The big difference between a 3(21) and 3(38) fiduciary, however, is that a 3(21) does not have discretion over the investments in the plan.

As a result, the committee, or another named fiduciary to the plan, will direct the 3(21) investment manager. This means that a plan sponsor or committee will not be able to relinquish any of the key decisions surrounding adding, removing, or replacing plan investments.

3(16) fiduciary

When a plan sponsor decides to offer a retirement plan, they oftentimes begin to look for professionals that can handle many of the plan functions necessary to provide a quality retirement program to their employees. As discussed above, their search often results in hiring an investment manager, who in turn can help them find a Third Party Administrator (TPA) to handle many of the day-to-day administrative duties involved in operating a retirement plan. Although a TPA handles many of the administrative functions of the plan, they do not make any discretionary decisions for the plan.

This can pose significant risks to the plan sponsor, who is the named fiduciary on the plan. As the named fiduciary, a plan sponsor has a number of required duties, such as operating the plan in accordance with the plan document, making sure that all required notices are provided to participants, and managing complicated rules and issues that arise, such as when the plan document needs to be applied to a particular situation. It is in these situations that a 3(16) fiduciary can help.

In a 3(16) fiduciary relationship, and in similar fashion to a 3(38) investment manager, the plan sponsor delegates many of these vital duties to a specialized plan administrator. The functions that a 3(16) fiduciary administrator can provide include:

- Preparation of, and signing off on, plan-related forms, including the Form 5500;
- Managing vesting, eligibility, and loan policies;
- Preparation and mailing of participant notices and disclosures; and
- Approval of all distributions from the plan.

By hiring a 3(16) fiduciary, plan sponsors shift some or all of their plan administration duties to a specialized plan administrator. That administrator will have full discretionary control, and will also accept fiduciary liability for the operation of the plan, including representing the company in an audit by the IRS or DOL.

As in the case of hiring a 3(38), 3(21) or 3(16) fiduciary, it is important to note that a plan sponsor does not abdicate all of their fiduciary liability by hiring expert fiduciaries. The plan sponsor still has the responsibility to oversee and monitor each plan fiduciary.

CREATE A COMMITTEE CHARTER AND CONFLICT OF INTEREST DOCUMENT

To help guide its fiduciary obligations with respect to the plan, the committee should establish a Charter. The purpose of the Charter is to outline the purpose, duties, responsibilities, and operations of the committee and its members. The Charter will serve as a framework for how the committee will conduct its activities. The Charter, along with the Investment Policy Statement, will provide important guidance to the committee, and both are important to maintain for compliance and recordkeeping purposes.

Each committee member has a duty of loyalty. This duty precludes them from being influenced by motives other than the accomplishment of the purposes of the plan. Committee members should never vote or participate in a determination in which they (or a family member) would receive a special gain or benefits.

As a result, committee members should complete a Conflict of Interest Questionnaire and Disclosure form, and submit it to the Secretary on an annual basis. These questionnaires should be retained indefinitely in the plan's fiduciary file.

CREATE AND FOLLOW AN INVESTMENT POLICY STATEMENT

The committee and the investment manager should work together to create and maintain an Investment Policy Statement (IPS). The IPS is intended to be a summary of an investment philosophy and the procedures that will provide guidance to the investment manager. The investment policies described in the IPS should be considered dynamic and reflect the plan's current investment philosophy regarding the investment of the plan assets. The IPS is intended to provide a prudent framework from which sound investment decisions can be made. As a result, it is important to remember that the IPS should serve as a roadmap for the selection and monitoring of plan investments, and that it is not a guarantee that any stated goals or investment performance will be attained.

When the management of the plan investments has been relegated to an investment manager, the IPS should assist the plan sponsor in effectively supervising, monitoring, and evaluating the management of the plan assets.

The sections of the IPS should look to cover the following areas:

- Clearly stating the attitudes, expectations, objectives and guidelines for the investment of the plan's assets;
- Setting forth an investment structure for managing all plan assets. This process includes offering various asset classes and investment management styles that will provide participants with the opportunity to diversify their investments appropriately in light of their objectives and risk tolerance;
- Defining certain duties and responsibilities to be performed by the various parties involved in the management and operation of the plan; and
- Compliance with all ERISA, fiduciary, and due diligence requirements that are consistent with all applicable laws and regulations that may affect plan assets.

The IPS should be reviewed at least annually by the investment manager and the committee to determine whether the stated investment objectives are still relevant and feasible, as well as whether they're being followed. It is not expected that the IPS will change frequently. Short-term changes in the financial markets should not require adjustments to the IPS.

LOG COMMITTEE MEETING MINUTES AND CREATE A FIDUCIARY FILE

When offering a retirement plan, it's essential for the plan sponsor to maintain careful and detailed documentation of important plan-related decisions, actions, and governing documents. This is especially true once a committee has been established and is meeting on a regular basis. All committee meetings should be well documented and stored securely, with backups in case of fire, floods, or data loss.

Committee meeting minutes are critical because they provide clear evidence of the meeting taking place, as well as decisions that were made, topics that were discussed, and exhibits that were incorporated into discussions. In the event of a plan audit by the DOL, providing meeting minutes is one of the best ways to provide evidence against a complaint. These documents can help provide a historical record, especially if the plan fiduciary needs to defend itself against litigation.

It is important to ensure that meeting minutes are as clear and concise as possible. The structure of a committee's meeting minutes should be consistent from meeting to meeting. In addition, they should be concise enough that they do not become so cumbersome or unwieldy that they are not recorded after a meeting takes place. It is recommended that a committee focus on the following when drafting meeting minutes:

- Approve the minutes from the prior meeting;
- List the start and end time of the meeting and attendees (ensuring a quorum was present);
- Include the considerations and reasoning behind decisions that are made;
- Attach all supporting documentation and exhibits that were included or referenced as part of the meeting;
- Record the outcome of any votes; and
- Do not focus on the details of discussions and excess details, but the outcome and/or decision that was reached.

The final copy of the meeting minutes should be saved in your fiduciary file (electronic and physical copies). The fiduciary file contains a record of all important documentation that substantiates plan actions, and it should serve as an ongoing record of how the plan arrived at where it is today. Documents contained in the fiduciary file should be retained in perpetuity in the event of an audit or to provide a historical record for future plan fiduciaries, such as when employee turnover occurs.

RECEIVE PERIODIC FIDUCIARY TRAINING

The ongoing training of a retirement plan fiduciary committee is essential. Documentation of periodic training is "one of the first questions asked by The Department of Labor (DOL) when conducting an audit," according to Jan Neri, an attorney at Faegre Drinker Biddle and Reath, LLP.

Training can come in many forms, which can/should include:

- Periodic reviews of each committee member's role. Each member should be assigned duties that best represent their experience and skill level;
- Review of plan documents, Summary Plan Description (SPD), and any ERISA rule changes or updates to the plan;
- Understanding fiduciary obligations to adhere to the IPS;
- Review the investment selection and removal process;
- Review of plan fees and expenses, and to check for fee reasonableness;
- Managing conflicts of interest;
- Monitoring of fiduciary and non-fiduciary plan providers;
- Recording meeting minutes;
- Review of committee performance; and
- Review the plan's long-term goals.

Committee members must adhere to the fiduciary duty of loyalty in the performance of their roles. Additionally, acting in the best interests of plan participants, and carrying out their duties in a prudent manner, encompass the core duties of a plan fiduciary.

CONDUCT PERIODIC FEE BENCHMARKING

It is recommended that at least annually, the committee (and all plan fiduciaries) monitor the compensation of plan service providers to ensure that their fees are reasonable. Not only is it important to know what fees are being paid by/for the plan (i.e. advisor fees, TPA/Recordkeeper fees, mutual fund expense ratios, etc.), but if these fees are considered reasonable as compared to the plan's peers (based on the company's industry and plan size, as measured by assets, and potentially by the number of participants).

A number of fee benchmarking services (free and/or subscription-based) are available online for plan fiduciaries. It is important to properly research a fee benchmarking service before using it in order to have a better idea as to the validity of the results that it generates. For example:

- How many plans are being incorporated into the peer benchmarking data?
- Is the benchmarking provider reputable?
- Are there limitations to a free benchmarking provider?

Last, if it is determined that a service provider is being paid more than its peers, it is important to put this in context and understand the value that they are providing to the plan. Are they providing more services than the average provider? If not, it may make sense to discuss a fee reduction, or potentially to issue a Request For Proposal (RFP) from similar service providers to help determine fee (and service) reasonableness.

HOW WE CAN HELP

DirectAdvisors, established in 2001 and located in Albany, New York, specializes in providing fiduciary oversight, advice, and guidance to retirement plans and investment committees through our fiduciary risk management services. We also provide bona fide benefit plan consulting and third-party administrative services to construction companies that are subject to the Davis-Bacon Act, Service Contract Act, and state prevailing wage regulations. Our clients are located throughout the United States and range in size from 10 to 3,000 employees.

In 2020, our construction company clients will contribute tens of millions of dollars of prevailing wage fringe benefit contributions to The DirectAdvisors Trust (health & welfare benefits) and retirement plans managed by our team.

Our solutions are free from any conflict of interest, as we do not sell any financial or insurance products.

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