



SPECTRUM
PENSION CONSULTANTS

Fiduciary Best Practices: A Guide for Small Employers

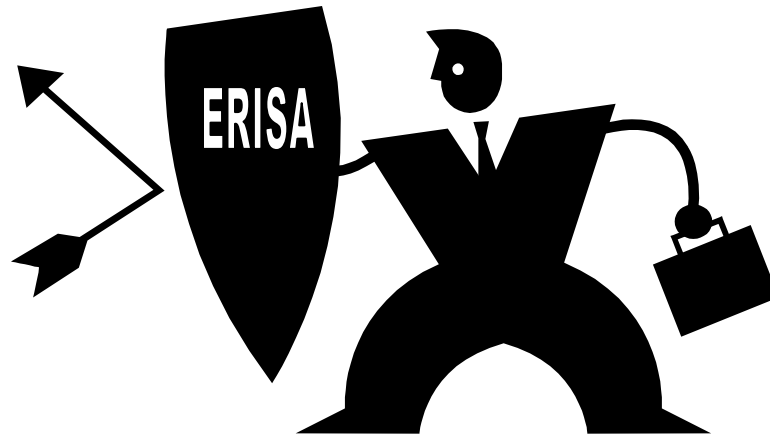
Kevin E. Boercker
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Which One Are You?



ERISA = Employee Retirement Income Security Act of 1974

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Fiduciary Rules 101

What Not to Do

Dealing with Service Providers

Managing Fiduciary Risk



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ERISA: A Fiduciary Is One Who

1. Has *Discretionary* Control of Plan Assets or Plan Management

2. Renders Investment Advice For A Fee

3. Administers Plan With *Discretionary* Authority

This is a *functional* definition: If you perform fiduciary functions then you are a fiduciary.



General Fiduciary Responsibilities

1. Exclusive Purpose
2. Prudent Person Standard
3. Diversifying The Investments
4. Follow Plan Documents
5. Keep Records

Fiduciary Standard: A fiduciary must discharge his/her duties solely in the interest of plan participants and beneficiaries



Emphasis on Process and Conduct, not Results

“[ERISA’s] test of prudence...is one of conduct, and not a test of the result of performance of the investment. The focus of the inquiry is how the fiduciary acted in his selection of the investment, and not whether his investments succeeded or failed.”

-Donovan v. Cunningham, 716 F.2d 1455, 1467 (5th Cir. 1983).

Fiduciary Rules 101



(Almost) Always

- Employer
- Plan Admin
- Trustee
- Investment Manager
- Custodian

Sometimes

- Directors
- Officers
- Employees
- Investment Service Providers

(Almost) Never

- Actuary
- Attorney
- Accountant
- Third Party Admin / Plan Consultant





Who is the “Ultimate” Fiduciary?

1. Authority To Appoint/Remove Other Fiduciaries

2. Typically Named as the Plan Administrator

3. It's Owners, Officers, or Directors are often Named *Individually* as Plan Trustees

Answer: The Employer



The Employer Wears Many Hats





The Employer Wears Many Hats



Business Owner

- Decisions regarding plan establishment, amendment and termination (aka settlor activities) are not fiduciary in nature
- Limited duty to disclose: can't mislead



The Employer Wears Many Hats



Plan Administrator

- Employer is often named as the plan administrator
- Responsible for plan operation and management
- “Ministerial” duties are not fiduciary functions



The Employer Wears Many Hats



Trustee

- Responsible for plan assets
- Can delegate to investment manager
- Can allow participant direction
- Directed vs. Discretionary trustee



Investment Service Providers

1. Must Actually Give Advice

2. Disc. Authority or Mutual Understanding That Advice is Primary Basis for Investment Decisions

3. Must Receive Direct or Indirect Compensation

If all three conditions are met then investment provider is a fiduciary under definition #2 above.



Best Practices / Action Items

1. Make A List Of All Plan Fiduciaries
2. Be Sure Fiduciaries Know Their Responsibilities
3. Check On Diversification
4. Create / Organize Your Plan “File”





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Prohibited Transactions

1. Basic Idea: Plan Cannot Engage in Certain Transactions with “Parties-in-Interest”
2. Purpose: Prevents Misuse of Plan Assets, Conflicts of Interest, and Self-Dealing
3. Scope: Rules Apply to All Fiduciaries, Plus Other Non-Fiduciaries





Rules Apply to:

1. All Fiduciaries
2. Service Providers
3. Plan Sponsor (e.g. Employer, Union)
4. Owners, Directors, Officers, EEs of #2 & #3
5. Family Members of Owners, Directors, etc.

Basically anyone “involved” directly or indirectly with the plan is a “party-in-interest.”



Types of Prohibited Transactions

1. Sale, Exchange or Lease of Property
2. Lending Money or Extending Credit
3. Furnishing Goods, Services or Facilities
4. Use of Plan Assets for “Other” Purposes
5. Self-Dealing





U.S. Labor Department sues former NFL player and others in bankruptcy court to recover pension assets

“The department's complaints allege that Vick violated his duties as a plan trustee under the Employee Retirement Income Security Act by making a series of prohibited transfers from the [MV7 Retirement] plan for his own benefit. The plan assets were partially used to help pay the criminal restitution imposed upon Vick after his conviction for unlawful dog fighting as well as his attorney in the bankruptcy cases.”

- DOL Press Release 3/25/09



*De Costa v.
Rodrigues
(9th Cir. 2009)*

Administrator Breached Fiduciary Duty Loaning Funds to Start-Up Company

-June 11, 2009 EBIA Weekly

Courts determined that administrator was “liable as a co-fiduciary by enabling the investment advisors fiduciary breach.”

The Administrator had a responsibility for **prudence and due diligence.**



T.C. Memo. 2004-260

UNITED STATES TAX COURT

JOSEPH R. ROLLINS, Petitioner v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Rollins, TC Memo 2004-260

CPA was owner of accounting firm and sole trustee of 401(k) plan. CPA loaned \$700,000 in 401(k) money to other companies in which CPA had minority interest. IRS claimed loans were transfers of the plan's assets that **benefited the CPA.**

Court stated “The fact that the transaction would qualify as a **prudent investment** when judged under the highest fiduciary standards is of **no consequence**. Furthermore, the fact that the plan benefits from the transaction is irrelevant. **Good intentions and a pure heart are no defense.**”

Result: PT w/ Excise Tax of \$164k



Late Deposit of Employee Contributions

Deferrals and Loan Payments become plan assets “as of the earliest date on which such contributions could reasonably be segregated from the employer’s general assets.” Holding onto 401(k) deferrals too long constitutes a prohibited transaction (a loan from the plan to the employer).

As of 2005 the DOL claims they obtained \$380 million in monetary “results” for participants and 159 indictments on this particular issue.



Other (potential) Pitfalls:

1. Allow Participants Access to “All” Investments
2. Illiquid or “Alternative” Investments
3. Different Investment Options for Owners
4. Use Plan to Get “Deal” on “Other” Services
5. Failure to Monitor Fees Paid by Plan
6. Failure to “Document”



Best Practices / Action Items

1. Do A Prohibited Transaction Self “Audit”
2. Review Any “Alternative” Investments
3. Monitor / Document 401(k) Deposit Process
4. Add Documentation To Your Plan File





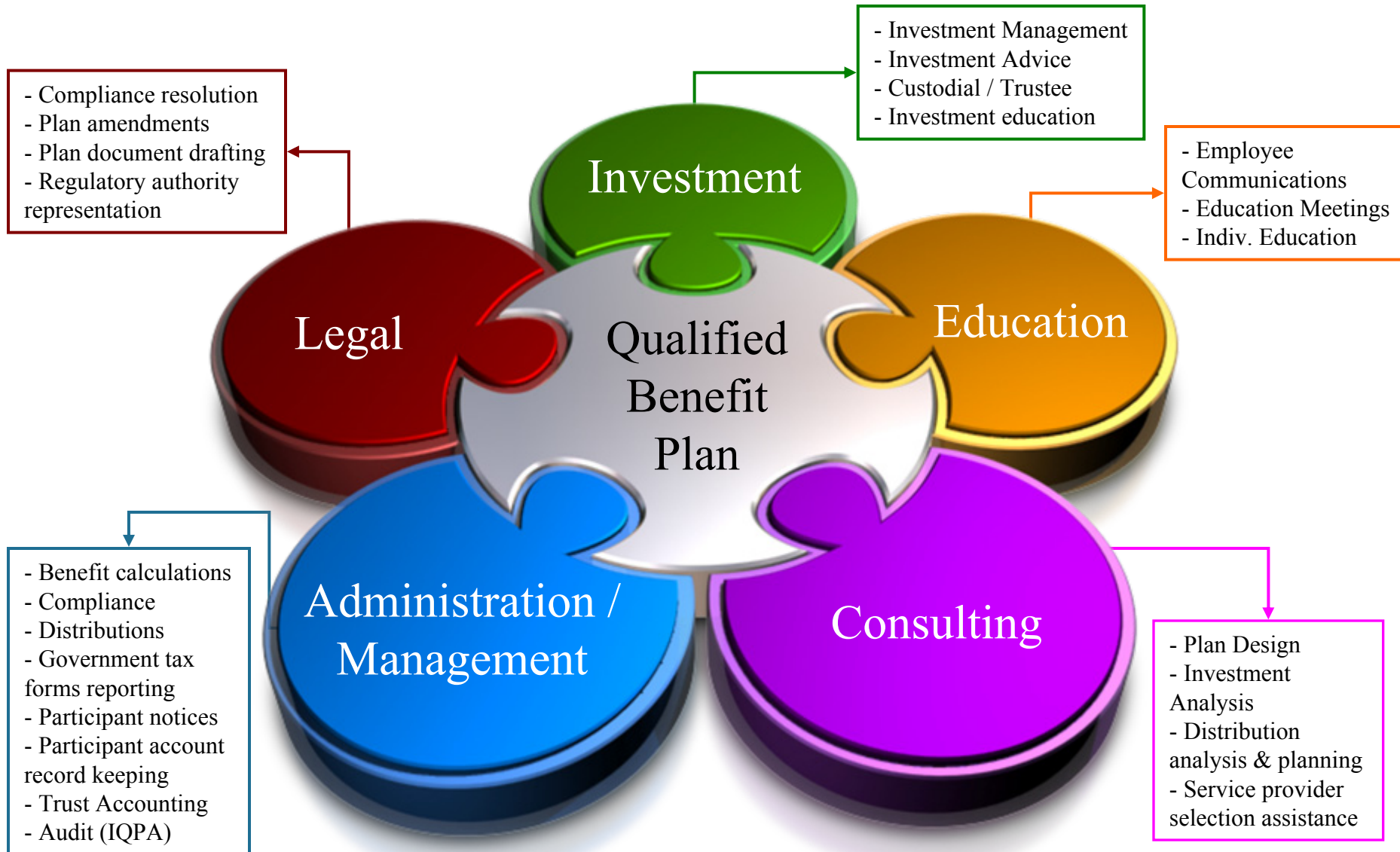
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Qualified Plan Services





Typical Service Providers

1. Plan Consultant
2. Recordkeeper
3. Investment/Financial Advisor
4. Custodian
5. ERISA Counsel

Certain providers will “bundle” some or all of these services together into a single offering



DOL Guidance For Employers When Selecting An Investment Advisor:

1. Quality of Services Offered
2. Reasonableness of Fees
3. Advisor's Experience and Qualifications
4. Willingness to Assume Fiduciary Status
5. Use of Accepted Investment Theories

Avoid Conflicts of Interest, Improper Influence



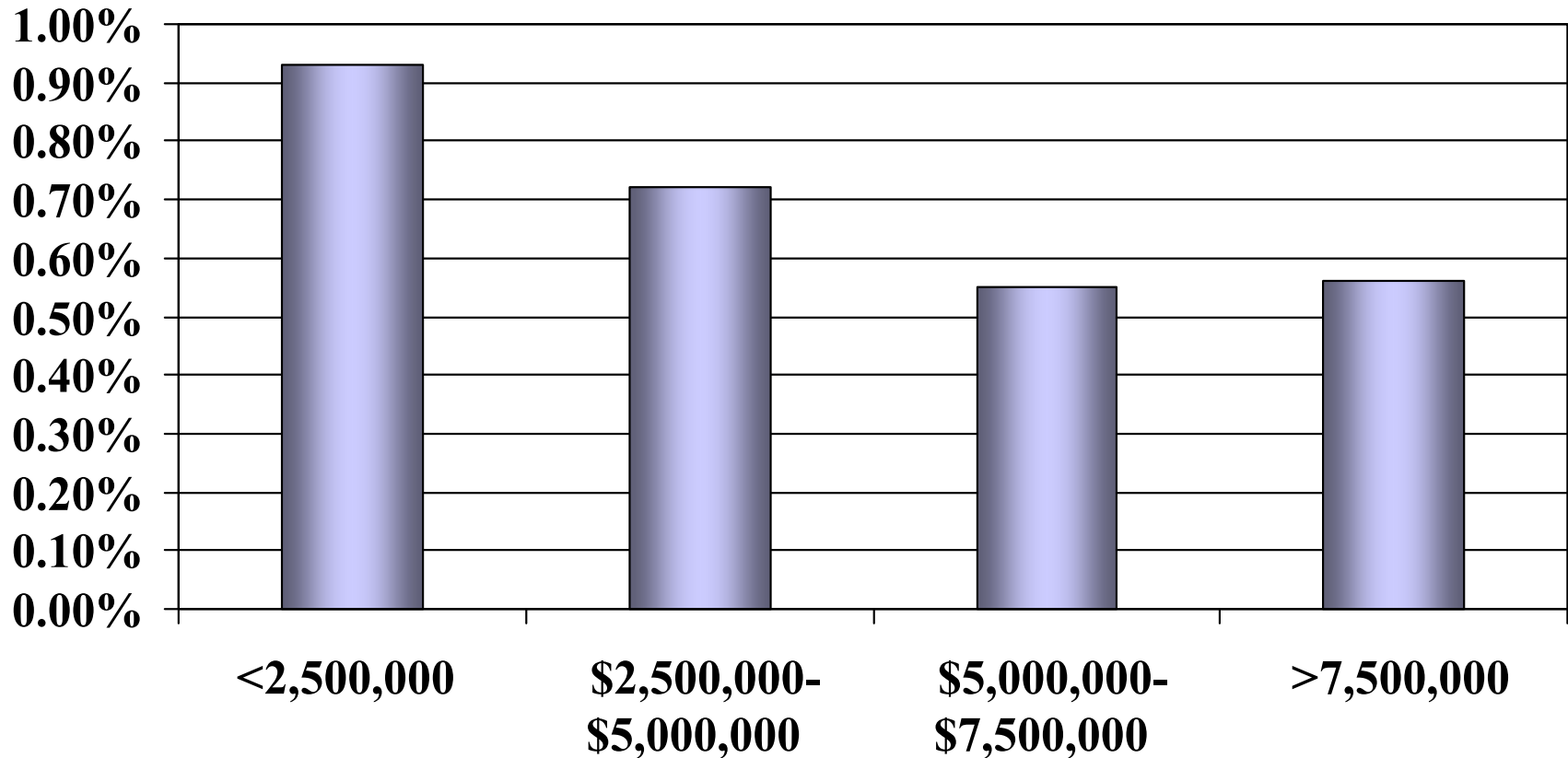
Typical Services Provided by Investment Advisors

1. Investment Policy (asset allocation)
2. Fund Selection and Monitoring
3. Performance Reporting
4. Investment Education
5. Enrollment and/or Rollover Assistance

Dealing with Service Providers



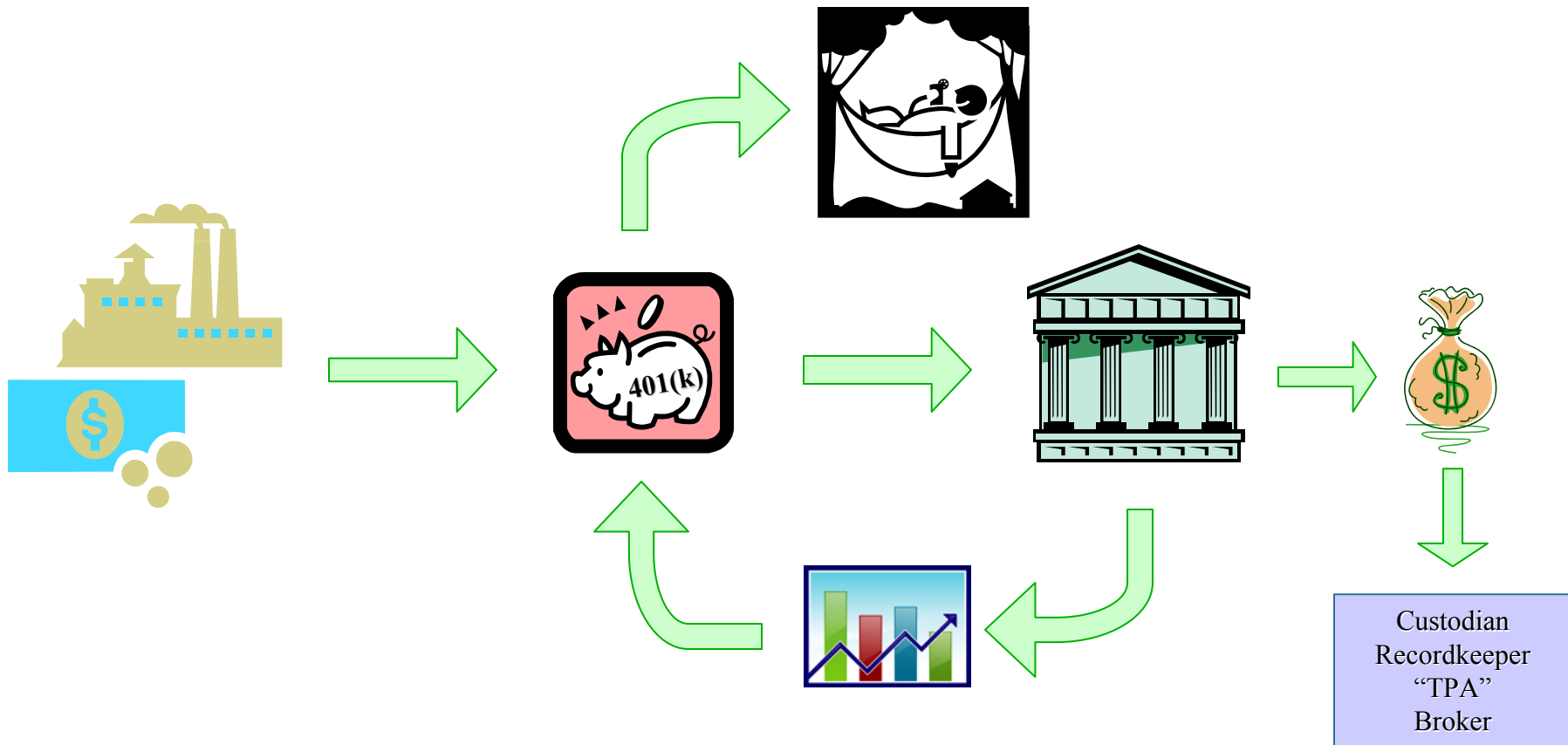
Average Annual "RIA" Fees as % of Plan Assets (2008)



Source: Spectrum Recordkeeping Plan Data



Understanding Fees: Revenue Sharing





Best Practices / Key Takeaways

1. Ask Providers: “Are You A Fiduciary”
2. Obtain Fee Info For All Providers
3. Create Procedure For Selecting/Monitoring Providers
4. Add Documentation To Your Plan File





Fiduciary Rules 101

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Managing Fiduciary Risk



What Risk?

1. Law Suit Defense
2. Regulatory Sanctions
3. Personal Liability





ERISA Litigation Data



ERISA LITIGATION STUDY

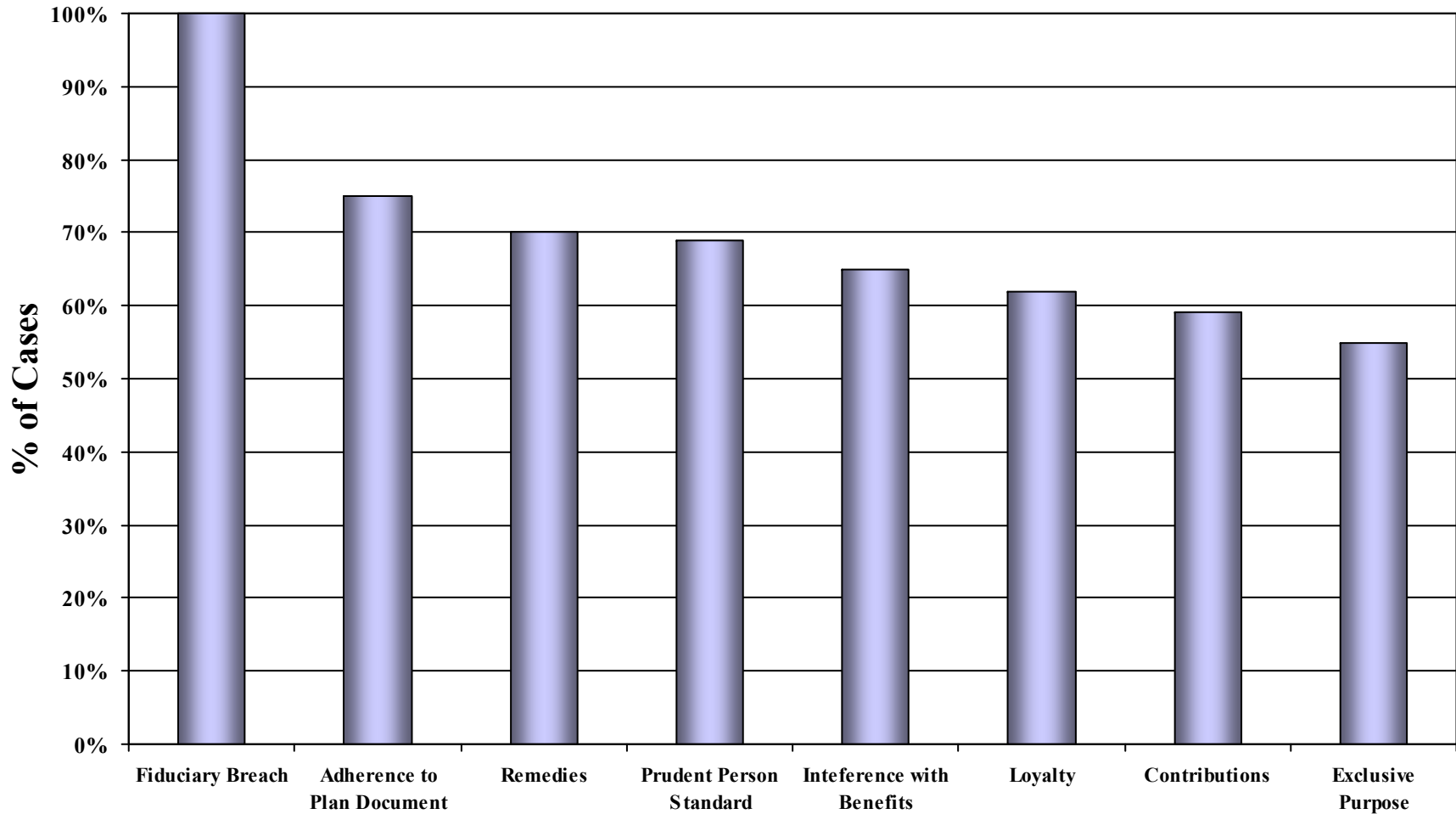
April 15, 2009

Source: <http://pensionlitigationdata.com/>
Joint Project: Pension Governance, Incorporated and
The Michel-Shaked Group

Managing Fiduciary Risk



Most Commonly Cited Issues in Litigation



Type Code Classification

Source: Pensionlitigationdata.com



Other Findings

1. Only 3% of ERISA Cases Disposed at Trial
2. % of Pension Plan Plaintiffs is Increasing
3. Most Cases Brought Under ERISA 502
4. District Courts Favor Plaintiffs
5. Appellate Courts Favor Defendants
6. 9th Circuit: Second Highest in Favor of Plaintiffs



2000 Fiduciary Liability Survey

1. 483 Self-selecting, Nonprobability Sample Set
2. Liability Limit: Median \$10 mil./Avg \$20.8 mil.
3. 12% Had At Least 1 Claim Over 10 Year Period
4. 47% Of Claims Related To Benefit Disputes
5. Average Defense Cost: \$124,000





Managing Risk: Options



1. Pass Risk to Others



2. Pay Others to Take Risk



3. Do It Yourself (correctly)



Pass Risk to Others: Participant Direction

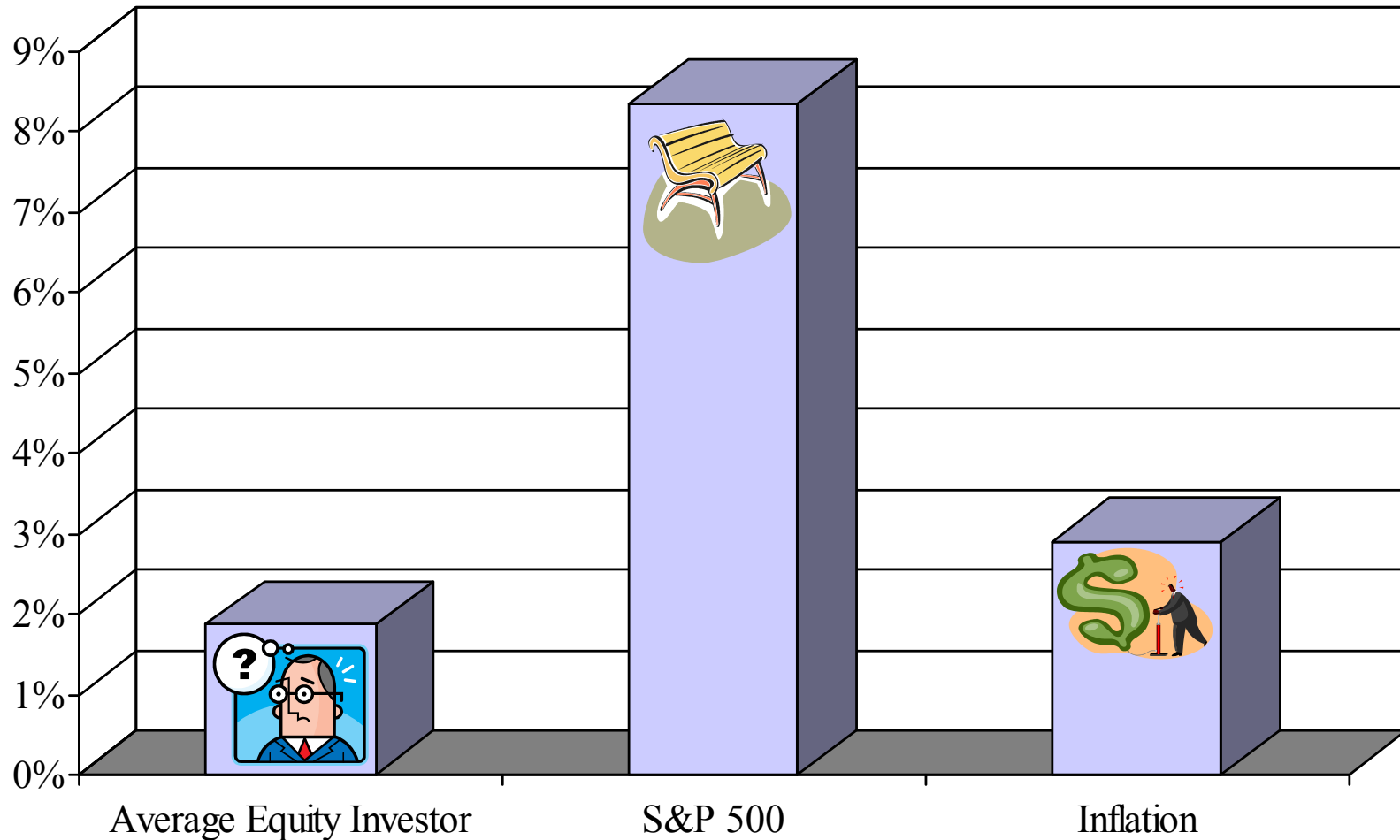
1. 404(c): Is it Worth It?
2. Protection Without 404(c)
3. Is Participant Direction “Prudent”?



Managing Fiduciary Risk



20 Year Average Return as of 2008



Source: Quantitative Analysis of Investor Behavior 2009 Study by DALBAR Inc.



Pass Risk to Others: Investment Advisors

1. Limits Other Fiduciaries' Responsibility (?)
2. The Fiduciary Advisor
3. Prudently Select and Monitor





Pay Someone Else to Take the Risk

1. Fiduciary Liability Insurance
2. Fidelity / ERISA Bonds
3. Employee Benefit Liability Insurance
4. Directors and Officers (D&O) Liability Policy





Doing It Yourself: Do It Right

1. Embrace Your Role As A Fiduciary
2. Become “*Familiar With Such Matters*”
3. Be An Advocate / Good Consumer
4. Document, Document, Document





Document, Document, Document

1. Have an Investment Policy Statement
2. Have Written Procedures
3. Write / Keep Meeting Minutes
4. Keep Records of Plan Assets





Best Practices / Key Takeaways

1. Check Your Insurance Policies
2. Revisit Investment Policy / Participant Direction
3. Continue (Or Start) Documenting Plan Meetings
4. Add Documentation To Your Plan File





Resources

<http://www.dol.gov/ebsa/fiduciaryeducation.html>

<http://www.spectrumpension.com/education-.aspx>

Website to “Check-Out” Providers

- Brokers: <http://brokercheck.finra.org/Search/Search.aspx>
- RIAs: http://www.adviserinfo.sec.gov/IAPD/Content/Search/iapd_OrgSearch.aspx
- Attorneys: <http://www.abanet.org/>
- Plan Consultants: <http://www.asppa.org/>
- General: <http://www.bbb.org/online/>



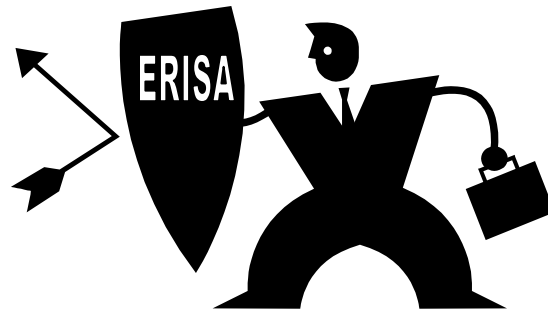
Conclusion

“It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so.”

- Mark Twain

“In a time of turbulence and change, it is more true than ever that knowledge is power.”

-John Fitzgerald Kennedy





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Questions



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