

**ERISA Fiduciary Responsibilities
for 403(b) Plans:
Keys to Implementation**

ERISA Fiduciary Responsibilities for 403(b) Plans: Issues and Implementation

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I. Introduction

1. ERISA and the Internal Revenue Code

- a. ERISA involves the U.S. Department of Labor
- b. Internal Revenue Code involves the IRS

2. Under ERISA, good intentions are irrelevant

3. Pension benefit plans subject to ERISA

- a. Generally include:
 - i. 401(k) plans
 - ii. defined benefit pension plans
 - iii. some 403(b) plans
 - iv. ESOPs
 - v. other types of pension plans
- b. Generally exclude:
 - i. 403(b) plans that (1) are limited to voluntary employee contributions and (2) have limited employer involvement
 - ii. governmental plans
 - iii. nonelecting church plans
 - iv. Keogh plans that cover owners only

4. Investment responsibilities and administrative responsibilities

- a. Fiduciaries have both responsibilities
- b. The focus of this presentation is on investment responsibilities

5. Different parties involved with ERISA pension plans

- a. plan sponsor
- b. plan trustee (N/A to 403(b) plans)
- c. custodian
- d. plan administrator
- e. recordkeeper
- f. other outside service providers

II. Overview of Fiduciary Responsibilities

1. Overall fiduciary responsibilities. A fiduciary is supposed to:

- a. Follow the “exclusive benefit” rule,
- b. Follow the “prudent man” rule,
- c. Follow the diversification rule, and
- d. Follow the plan document

ERISA §404 - Fiduciary Duties.

(a) Prudent man standard of care.

(1) Subject to sections 403(c) and (d), 4042, and 4044, a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and—

(A) for the exclusive purpose of:

(i) providing benefits to participants and their beneficiaries;

(ii) defraying reasonable expenses of administering the plan;

(B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and *familiar with such matters* would use in the conduct of an enterprise of a like character and with like aims; [Emphasis added.]

(C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

(D)) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with provisions of this title and title IV.

Regulation §2550.404a-1 Investment duties.

(b) Investment duties.

(1) With regard to an investment or investment course of action taken by a fiduciary of an employee benefit plan pursuant to his investment duties, the requirements of section 404(a)(1)(B) set forth in subsection (a) of this section are satisfied if the fiduciary:

(i) Has given appropriate consideration to those facts and circumstances that, given the scope of such fiduciary's investment duties, the fiduciary knows or should know are relevant to the particular investment or investment course of action involved, including the role the investment or investment course of action plays in that portion of the plan's investment portfolio with respect to which the fiduciary has investment duties; and

(ii) Has acted accordingly. [Emphasis added.]

2. See DOL summary entitled “Meeting Your Fiduciary Responsibilities” (pg 15)

- a. Know your duties and responsibilities
- b. Fiduciaries have personal liability
- c. Extremely important to have a “process” in place
- d. Extremely important to "document" that the process is being followed

3. Examples of “process”

- a. Create an Investment Policy Statement (IPS)
 - i. See sample IPS on page 10
- b. Form an Investment Committee
- c. Document all activities and decisions
- d. Select plan investments, service-providers and fiduciaries
- e. Monitor plan investments, service-providers and fiduciaries

4. Understand all fee and service arrangements

- a. What administrative services are provided?
- b. What investment advisory services are provided?
- c. What employee education is provided?
- d. Are any plan advisors serving as fiduciaries? Is arrangement in writing?
- e. What fees are paid directly or indirectly from plan assets? Fees paid from plan assets should be subject to additional scrutiny. Need to understand fees for at least two reasons:
 - i. Assess reasonableness of totality of fees, and
 - ii. Avoid conflicts of interest that lead to prohibited transactions

- f. Fees paid from plan assets can make a difference to net investment return

Example: Savings of \$10,000 per year (\$833.33 per mo) will accumulate to \$841,300 in 30 years at 6% per annum but will accumulate to \$926,800 in 30 years at 6½ %. Difference of \$85,500 equals a 10% increase. A 7% return will accumulate to \$1,022,600 with an additional \$181,300 for a 21.5% increase.

- g. Are all fees fully disclosed in writing? Two sets of DOL regulations that become effective 1/1/12:
 - i. Require service-providers to make certain fee (and service) disclosures to the plan fiduciary (see summary on page 36); and
 - ii. Require plan administrator to make certain fee (and investment) disclosures to the plan participants (see summary on page 28)

- h. Are all fee and service arrangements reviewed periodically?

III. Who is an ERISA Plan Fiduciary?

1. The Law:

A person is a fiduciary of an employee benefit plan to the extent that the person:

- a. exercises discretionary authority or control respecting management of such plan or management or disposition of its assets;
- b. renders (or has authority or responsibility to render) investment advice for a fee (or other direct or indirect compensation); or
- c. has discretionary authority or responsibility in the administration of such plan.¹

A person designated as a plan administrator, plan fiduciary, or trustee is probably a fiduciary by virtue of his position.²

A person who has no title with regard to a plan may be fiduciary by virtue of his conduct or responsibility. A person who acts in a fiduciary capacity is a fiduciary (whether he wants to be or not).

2. Discretionary Authority or Control Over Management of Plan or Plan Assets

- a. **Title:** Plan administrators and trustees of a plan act as fiduciaries when they possess discretionary authority to manage the plan or its assets.
- b. **No Title:** Other individuals may have such discretionary control.
- c. **Consultants:** Attorneys and accountants who render ordinary legal, accounting, or consulting services to an employee benefit plan are not fiduciaries.³

¹ ERISA §3(21)(A); IRC §4975(e)(3).

² ERISA §402(a) requires every plan to name one or more “named fiduciaries” who “jointly or severably have the authority to control and maintain the operation and administration of the plan”.

- d. **Board Members:** Decisions regarding the selection or retention of fiduciaries are fiduciary decisions. Therefore, members of the board of directors are fiduciaries to the extent that use their authority to pick fiduciaries, such as trustees.
- e. **Corporate Officers/ Fiduciary v. Settlor Functions:** An employer (or an officer acting for an employer) does not act as a pension plan fiduciary when it performs "settlor" functions.

In general, decisions regarding the establishment, design, or termination of a plan are settlor functions. Decisions made to implement design decisions are generally fiduciary in nature, and decisions regarding the investment or payment of plan assets are usually fiduciary decisions. Sometimes the distinctions can be very grey.

For example, a decision whether to pay plan expenses from plan assets or corporate assets is a settlor function. On the other hand, a decision to use plan assets to pay a particular expense is a fiduciary decision.⁴

- f. **DOL Proposed Regulations:** On October 21, 2010, the DOL issued proposed regulations that would, if adopted, broaden the definition of a fiduciary.

³ However, they can become fiduciaries if they give investment advice or exercise discretionary authority over plan assets or plan administration.

⁴ If you want to use plan assets to pay plan expenses, you need to do a very careful analysis as to which expenses are plan expenses and which expenses are settlor expenses. For example, if the plan sponsor hires a consultant to advise it about possible plan design changes, the cost for that consultant is probably a settlor expense, and it would be a breach of fiduciary duty to pay it from plan assets. For starters, see DOL Advisory Opinions 83-20A, 86-01A, 89-09A, 93-06A, 97-03A, and 2001-01A.

IV. Process for Meeting Fiduciary Responsibilities

1. Investment Policy Statement (IPS)

- a. Creates standards/benchmarks for selecting and monitoring plan investments and service-providers. It provides road map for fiduciaries to follow on an ongoing basis.
- b. IPS should be consistent with the plan document and trust agreement
- c. See the sample IPS on page 10.

2. Investment Committee

- a. Establish membership, responsibilities, frequency of meetings
- b. Serve as decision-maker or advisor?
- c. Decide whether to engage outside investment advisor

3. Indemnification

- a. Plan sponsor should indemnify inside fiduciaries
- b. Fiduciary insurance may be purchased
- c. Check current insurance policies to confirm any potential coverage

4. Selecting and monitoring investment options

- a. If wish to offer broad array of mutual funds, the plan may offer:
 - i. Domestic equity, fixed income and balanced funds
 - ii. Foreign funds
 - iii. Cash funds
 - iv. Target date funds and/or allocation models
- b. Broad mix of domestic equity funds might be as follows:

	Growth	Blend	Value
Large	x	x	x
Mid	x		x
Small	x		x

5. Limiting Fiduciary Liability Under ERISA 404(c)

Compliance with ERISA 404(c) shifts part of the fiduciary responsibility to the participants and provides a plan sponsor with a strong defense against fiduciary liability suits for investment performance. ERISA 404(c) applies if:

- a. The Plan allows participants to direct investment of their accounts within a broad range of investment alternatives (including at least three diversified alternatives).
- b. The Plan allows participants to change their investments as frequently as appropriate based on the investment alternatives provided (but not less frequently than quarterly).
- c. Plan fiduciaries:
 - i. provide specific disclosure to the participants, and
 - ii. make other information available to participants.
- d. Participants receive an explanation that the plan is intended to constitute a plan described in ERISA 404(c).

6. Default Investments

- a. Safe harbor choices are available:
 - i. Life cycle or target date funds
 - ii. Balanced funds(s), or
 - iii. Professionally managed account
- b. Employees must be notified.
- c. On 11/30/10, the DOL issued proposed regulations which (once they become final) will require additional disclosures about target date funds. There is some speculation that DOL hopes to finalize these regulations in time to be effective 1/1/12.

V. Summary of Implementation Steps

1. Review and understand plan investments, fees and service arrangements
2. Create and follow “process” for initial selections (e.g., Committee, IPS, etc)
3. Create and follow “process” for on-going monitoring
4. Document due diligence by documenting all fiduciary activities/ decisions
5. Engage competent outside experts
6. Confirm whether have outside co-fiduciaries
7. Indemnify appropriate parties
8. Comply with ERISA 404(c) and the safe harbor "default investment" provisions if your plan permits participant to direct their investments
9. Delegate fiduciary responsibilities to one central party?

VI. Additional Next Steps For Consideration

1. Confirm with your service-provider(s) that your plan will be in compliance with the two sets of DOL regulations that become effective 1/1/12.
 - a. Summaries of these regulations are provided on pages 28 and 36.
2. Look more closely at any target date funds included in your plan and how these funds are communicated to your employees.
 - a. Consider sending to your employees the Model Bulletin jointly prepared by the DOL and the SEC (shown on page 39).
3. Revisit "automatic enrollment" if it hasn't been considered recently. This is optional but worth considering if employee participation is insufficient. According to recent survey, 57% of surveyed savings plans currently have automatic enrollment while 13% of those not offering it intend to offer it during 2011.

The Pension Protection Act of 2006 ("PPA") removed three obstacles that previously that it difficult to use automatic enrollment. Under the PPA:

- a. Any state law withholding restrictions are preempted
 - b. Disgruntled employees have 90 days to reverse the automatic enrollment and demand a refund
 - c. Safe harbor default investments are available
4. Consider employee communication campaign about "retirement readiness".

SAMPLE

403(b) plan

Investment Policy Statement

Investment Policy Statement for the "ORGANIZATION" 403(b) Plans

"ORGANIZATION" has two retirement plans that are 403(b) tax-deferred annuity plans ("Plans"). The Plans are intended to provide eligible employees with an opportunity to accumulate wealth for their retirement and to comply with Section 403(b) of the Internal Revenue Code. Plan assets are held in annuity contracts and custodial accounts with TIAA-CREF. Alternate Vendor has been added as a second money manager and recordkeeper.

The Plans are participant-directed plans that are intended primarily to be "ERISA Section 404(c) Plans" within the meaning of the Department of Labor regulation 2550.404c-1 ("404(c) regulations"). Each participant may decide how his or her contributions shall be invested, and no fiduciary shall be liable for any loss that results from a participant's exercise of control over the investments to the extent that the 404(c) regulations are met.

The "ORGANIZATION" has appointed the Employee Retirement Investment Committee ("Committee") and its members to select and monitor the investment options offered under the Plans. Committee membership may change from time to time as determined by the Committee. The Committee may engage outside experts for counsel and rely on such counsel.

Purpose for the Policy Statement

The Committee has adopted this investment policy statement ("IPS") to summarize its policy for the selection, monitoring and evaluation of investment options offered under the Plan and to assist it in meeting its fiduciary responsibilities under ERISA as of the date of its execution. The Committee may revise the IPS from time to time as it thinks is appropriate.

The Committee will perform its duties with the skill, care, and diligence that a prudent individual acting in a like capacity would undertake and in accordance with all aspects of applicable law, including the requirements of ERISA and the Internal Revenue Code. Within this context, the Committee will attempt to act to the best of its ability based on historical investment data that it reviews and is not attempting to forecast or ensure the future performance of investments held by the Plans. The Committee shall convene periodically as it deems necessary in order to perform its duties and shall convene no less frequently than annually.

Investment Options

The Plan should offer a broad range of investments that will provide each participant with the ability to construct a diversified portfolio to meet the participant's long-term investment goals. Participants should be able to construct diversified portfolios that reasonably span the risk/return spectrum.

The Plan's investment options will be selected to:

- Maximize return within reasonable and prudent levels of risk.
- Provide returns comparable to returns for similar investment options.

- Provide exposure to a wide range of investment opportunities in various asset classes.
- Control administrative and management costs.

Plan investments shall be invested as part of an annuity contract or as part of a custodial account. Annuity contract means a contract that is issued by an insurance company qualified to issue annuities in a state and that includes payment in the form of an annuity. Custodial account means a separate account under a Plan that meets the requirements of Code section 401(f)(2). The Committee may select investment options that are permissible under Code section 403(b) and may change the selected investment options from time to time. The investment options should enable the participants to construct an investment portfolio appropriate for their investment objectives and risk tolerance.

Since the participants may have varying needs, the Plans shall offer investment options from various asset classes. For each different asset class, the Committee may develop and use an index and category for evaluation purposes. The Committee will need additional time to develop the appropriate standards for reviewing investments held under the TIAA-CREF annuity contract.

Any index fund held by the Plans shall be evaluated by comparatively evaluating its fees and its ability to track its investment goals efficiently and shall not be held to the same three-year and five-year time horizons as described below for the other fund types within their respective categories.

Similarly, any life cycle mutual funds held by the Plans shall not be held to the same three-year and five-year time horizons as described below for the other fund types within their respective categories since the fund categories for life cycle funds are not as mature as other fund categories. The other guidelines described below shall continue to apply to any such life cycle funds along with expectations that the life cycle funds have competitive returns.

Guidelines for Selecting Mutual Funds

The following criteria will be considered to select the mutual funds and shall apply only at the time of selection of the fund, unless otherwise specified below. The following criteria do not necessarily apply to the selection of index funds and need not apply to mutual funds added under the TIAA-CREF arrangement if the Committee believes that such investments are prudent within the context of the entire TIAA-CREF arrangement.

1. Preliminary Review:

a. Fund History

Each investment fund is required to have a minimum of five years of history. Small cap and mid cap domestic equity investment funds are required to have at least three years of operating history.

b. Relative Performance

Each investment fund generally is required to have performed in the top one-third of its investment category on both a three and five-year basis. Small cap and mid cap domestic equity investment funds are required to have a three or five-year rank in the top third of their category. An exception to this standard applies to index funds and may apply to any fund that the Committee believes is a prudent selection otherwise.

c. Manager Tenure

Each investment fund is required to have had the same portfolio manager or a member of the same management team in place for at least the previous three years. Due to the reduced history requirement for small cap and mid cap domestic equity funds, portfolio manager tenure is reduced to two years in this category.

d. Minimum Assets

All investment funds are required to have a minimum of fifty (\$50) million dollars in assets under management except small cap and mid cap domestic equity investment funds, which are required to have minimum assets of twenty-five (\$25) million dollars.

e. Expenses

Each investment fund selected is required to have an overall expense ratio that is no more than 25% above the average expense ratio for the respective investment fund category. All purchases shall be made at the net asset value (NAV) with no loads.

2. Final Review:

After screening available investment funds based on the above stated criteria, factors such as Sharpe ratio, style consistency, risk, beta, standard deviation and percentage of calendar years below median performance may be considered for final investment fund selection.

Guidelines for Monitoring Mutual Funds

Plan assets will be invested through TIAA-CREF and Alternate Vendor, who serve as the Plans' recordkeepers and custodians. The availability of investment options through TIAA-CREF is currently governed by the TIAA-CREF arrangement. Consequently, the following standards may not apply completely to proprietary investment options offered under the TIAA-CREF arrangement but will apply to investment options offered through Alternate Vendor and will apply to any nonproprietary mutual funds offered under the TIAA-CREF arrangement.

The performance of the investment options offered through TIAA-CREF shall be monitored as a total package since that is how the TIAA-CREF investment options are available, although the Committee will be mindful of the following standards while monitoring the performance of the overall arrangement offered through TIAA-CREF.

Mutual funds generally shall be evaluated using whatever indices and categories are found to be appropriate and shall maintain the minimum criteria used in the selection process, except as noted below. The Plans shall offer at least five different fund types and may offer additional investment options.

1. Relative Performance

Once selected, each investment fund [except for Index, small cap, mid cap, foreign and specialty equity funds] is required to fall into the 1st or 2nd quartile of all funds in its fund category on both a three-year and five year basis. All small cap, mid cap, foreign and specialty equity funds are required to fall into the 1st or 2nd quartile on *either* a three or five year basis. An Index fund shall not be required to fall into the 1st or 2nd quartile of all funds in its fund category on either a three-year or five-year basis but rather shall be evaluated based on its comparative fees and its ability to track the appropriate index efficiently.

2. Manager Tenure

When a sole investment fund manager leaves a fund, the fund will be placed on "watch list status". In the case of a fund that uses a team of managers, the loss of one member from the team of managers will not necessarily result in the fund being placed on "watch list status".

The Committee realizes that investment options generally must be given a full market cycle to achieve stated objectives. Thus greater weight will be given to market-cycle performance than performance in any given year or quarter. However, the Committee realizes that economic, political, or other changes may occur requiring action sooner than a full-market cycle. A "full market cycle" generally is a period that includes a bull market and a bear market.

Should an investment fund's performance place it below the above standards, the Committee shall decide whether to replace the fund with a similar fund, compliment the fund with a similar alternative, or place the fund on a "watch list status" for possible replacement or compliment within a 12-month period.

Should a fund exhibit management style inconsistency such that it would no longer fit the criteria for a particular fund category, the Committee shall decide whether to replace the fund or compliment the fund with an alternative that does meet those criteria. Allegations of any ethical breaches or improper fund practices should be factored into any such decisions.

Fees and Expenses Charged to Participant Accounts

The Plan participants shall be periodically advised about any fees or expenses that are charged to the participants' individual accounts under the Plans.

Coordination With The Plan Documents

Notwithstanding the above, if any term of this investment policy conflicts with any term of the Plan documents, the Plans' term shall control except to the extent that such term is inconsistent with ERISA.

