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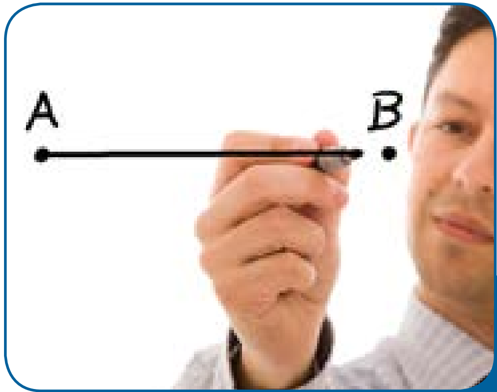
Welcome to the Fiduciary Resource Center!



Additional Information

Fred Reish Biography

Welcome to the Fiduciary Resource Center!

Fiduciaries embark on a journey to reach their final destination – a plan that provides a financially-secure retirement for the employees who participate. In order for a fiduciary to manage a plan that will reach that destination, the fiduciary must understand the rules of the road. This fiduciary resource center describes the rules and provides assistance along the way.

More specifically, this resource center will help plan sponsors and fiduciaries understand their legal responsibilities for overseeing the administration and investment of retirement plans under ERISA – the Employee Retirement Income Security Act.

The Fiduciary Resource Center was created in partnership with Fred Reish, Bruce Ashton and Summer Conley of the nationally known employee benefits firm, Drinker Biddle & Reath, LLP. This resource center is not intended to cover all the rules that apply to fiduciaries; that would be too complicated and lengthy. Instead, we have used our judgment to select and discuss the most important rules, based on our years of experience to provide fiduciaries with a meaningful and readily accessible guide to understanding and managing legal responsibilities.

FRED REISH BIOGRAPHY

Fred Reish has been recognized on several occasions for his contributions to the 401(k) community: the ASPPA/Morningstar Leadership Award; the 401(k) Industry's Most Influential Person for 2007 by 401kWire; the Commissioner's Award and the District Director's Award by the IRS; the Harry T. Eidson Founder's Award by American Society of Pension Professionals and Actuaries; the Institutional Investor Lifetime Achievement Award; and the Plan Sponsor Magazine Lifetime Achievement Award. He was also selected by Plan Sponsor Magazine as one of the "15 Legends" in the development of retirement plans. In addition, he has been recognized in the legal community as a Charter Fellow of the Employee Benefits Counsel, as one of "The Best Lawyers in America," and as a "Super Lawyer in Southern California."

He has written over 250 articles and four books about retirement plans, including a monthly column on 401(k) fiduciary issues for Plan Sponsor magazine.

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A Legal Definition of Each Fiduciary Role

Are you a fiduciary? If you are involved in the administration of a retirement plan or the management of its accounts, you are probably an ERISA fiduciary. In order to understand your responsibilities and to fulfill your duties as a fiduciary, you need to understand what a fiduciary is and who the fiduciaries are.

A fiduciary is anyone who:

- has authority under the plan to manage plan investments or who actually exercises control over those investments;
- gives investment advice for a fee; or
- has discretionary authority for the administration of the plan.[1]

That means that anyone who is given (or takes it upon himself to exercise) decision-making authority over the investments or discretionary authority over the operation of the plan is a fiduciary. A plan can have one fiduciary that performs all of the functions or it can have several fiduciaries that perform different functions. The distinction is important. As a general rule, fiduciaries are only responsible for the duties delegated to them and accepted by them. However, if a fiduciary starts making decisions or exercising control over other plan operations, the fiduciary can become a fiduciary for those actions as well.

[1] ERISA Section 3(21)(A) *Donovan v. Bierwirth*, 680 F.2d 263, 272 (2d Cir. 1982)

Legal Descriptions of Each Fiduciary Role

There are two types of fiduciary: *named* fiduciaries (including appointed fiduciaries) and *functional* fiduciaries.

A named fiduciary is a person or committee who is given fiduciary responsibility by the terms of a plan. The plan document either names that person or describes a procedure for his selection (for example, the plan says that the committee will be appointed by the Board of Directors of the company).[2] Named fiduciaries are assigned duties by the plan document or by the person(s) who appointed them and therefore should know that they have responsibilities.

CASE STUDY

Identify the Named Fiduciaries

Acme Company sponsors a 401(k) plan for its employees. The trustee of its plan is XYZ Financial. The plan includes a provision which allows the sponsoring company to appoint a committee to manage the plan. Shortly after adopting the plan, the Acme Company Board of Directors (the "Board") appoints a committee to manage the plan and select its investments.

The named fiduciaries are: Acme Company, the Board, XYZ Financial and the appointed committee.

Why: The sponsoring employer and the trustee are always named fiduciaries. Therefore, Acme Company as the sponsoring employer and XYZ Financial as the trustee are named fiduciaries. As discussed above, a named fiduciary can also be an individual or group of individuals who are selected by a procedure outlined in the plan. Since the plan includes a procedure for appointing a committee, the appointed committee is a named fiduciary. By appointing the committee, the members of the Board become fiduciaries. However, the Board members are limited fiduciaries for the purpose of selecting and monitoring the plan committee and its members. Basically, the Board's job is to make sure the committee members are qualified and are fulfilling their responsibilities.

[2] ERISA §§402(a)(1), 402(a)(2)

A *functional* fiduciary is someone who is not authorized by the plan document to manage the plan or its assets, but who in fact exercises control over the plan's money or investments.[3] That person is a *functional fiduciary* because he or she has acted—or functioned—as a fiduciary even though not appointed to that job. In some cases, functional fiduciaries make those decisions without understanding the consequences and are surprised to learn that they took on that status—and the related responsibilities.

In other words, anyone who is given the authority or who takes actual control of the operation of the plan, or of the management or disposition of plan money takes on fiduciary responsibilities and must perform those duties according to high fiduciary standards and for the exclusive benefit of the participants.[4] However, it is important to understand that status as a fiduciary is not an all or nothing concept. That is, a person may be a fiduciary for only one aspect of plan administration but have no responsibility for other parts of the operation of the plan.[5] In other words, a fiduciary is only responsible "to the extent" he is a fiduciary. (An exception is found in the co-fiduciary rules. See the Co-Fiduciary Responsibilities page under the "My Fiduciary Responsibilities" section.)

CASE STUDY

Identify the Functional Fiduciaries

Acme Company sponsors a 401(k) plan for its employees. The CFO of Acme Company selects the investments for the 401(k) plan.

The fiduciaries are: Acme Company and the CFO of Acme Company.

Why: As mentioned in the example above, the sponsoring employer is always a fiduciary. By selecting the investments for the plan, the CFO has exercised control over the plan investments and has become a functional fiduciary subject to ERISA's prudent man standard of care and its fiduciary duties (*e.g.*, the duty to monitor).

[3] *Mertens v. Hewitt Associates*, 508 U.S.248 (1993), performing mechanical administrative tasks is insufficient to confer fiduciary status, but having "discretionary control" over plan administration makes an individual a functional fiduciary.

[4] *Mertens v. Hewitt Associates*, 508 U.S. 248 (1993).

[5] 29 C.F.R. § 2509.75-8, FR-16.

Detailed Fiduciary Descriptions

Plan Administrator

A "plan administrator" is the person designated to be responsible for the administration of the plan.[6] Many plans appoint a committee for these responsibilities. If a plan administrator is not designated in the plan document, the plan sponsor is the plan administrator.[7] The plan administrator is always a fiduciary.[8]

However, the plan administrator may hire a third party administrator (TPA) or a recordkeeper to provide services to the plan. These services often include technical compliance, plan documents and employee communications. These "service providers" typically are not fiduciaries.

ACTIVITIES OF A PLAN ADMINISTRATOR

Acme Company sponsors the Acme Company 401(k) Plan. Acme Company is identified as the plan administrator. As the plan administrator, Acme Company must be attentive to the proper administration of the plan, including, among others, the following tasks:

- properly enrolling employees in the plan;
- monitoring the administration of the plan, including the firm which provides administrative services (such as allocating amounts to the participants' accounts); and
- calculating and paying benefits, or overseeing that those functions are done properly.

[6] ERISA § 3(16)(A)(i).
[7] ERISA § 3(16)(A)(ii).
[8] 29 C.F.R. § 2509.75-8 D-3.

PRACTICAL TIP

The IRS provides a checklist for 401(k) plan sponsors to review each plan year. This checklist contains helpful information for plan sponsors. In particular, this checklist reminds plan sponsors to:

- supply their third party administrator (TPA) or adviser with information regarding all employees who receive a Form W-2 (by doing this a plan sponsor may reduce the risk of omitting eligible employees) and
- notify plan service providers right away about any changes in the form or operation of your plan.

Plan sponsors should review this checklist annually. This checklist can be found at: **www.irs.gov** and enter **publication 4531** in the search box.

The Plan Committee

A plan committee typically is both the plan administrator and the primary investment fiduciary. The committee's administrative duties include interpreting the plan document; determining eligibility of employees to participate; and hiring the plan's service providers, such as the plan provider, investment adviser and accountants. The committee's investment responsibilities are to select and monitor the funds offered to the participants, as well as selecting the plan's investment services offered for the participants.

The job of the committee members is to oversee the operation, or administration, of the plan and also to oversee the investment of the plan's money. Because of its broad discretion over the plan's operations and investments, the committee—and each of its members—is a fiduciary.

PRACTICAL TIP

Who is Typically Appointed to a Plan Committee?

Typically, the members of the plan committee are the key officers of the company. In the case of smaller companies, the plan committee often consists of the company president, the chief financial officer and the office manager. For larger companies, it can consist of the vice president of human resources, the chief financial officer, other human resources and/or finance personnel, and an attorney from the general counsel's office.

Company Directors and Company Officers

The directors and officers of a plan sponsor may be fiduciaries if they serve on a plan committee, if they appoint and control other fiduciaries, if they have discretionary authority over plan investments or administrators, or if they function as a fiduciary by making decisions about the management of the investments.[9] For example, the members of the board of directors often select the trustee and the committee members. So, members of a board are fiduciaries to the extent they select those individuals, and therefore they have a duty to mutually select them in a prudent fashion and to monitor them on an ongoing basis. In addition, an officer will become a functional fiduciary if he or she selects the investments for the plan, even if the officer is not given that responsibility by the plan or the company. As such, the officer has a legal duty to engage in a prudent process to select those investments–and an ongoing duty to prudently monitor them… and, when needed, to remove and replace inferior investments.

DIRECTORS AND OFFICERS AS FIDUCIARIES

The Board of Directors of Acme Company (the "Board") is responsible for appointing members of the plan committee. The CFO is a member of the Board. The Board appoints the CFO and other officers of the company to the plan committee.

The fiduciaries are: The members of the Board and the members of the plan committee.

Why: By appointing the members of the plan committee, the members of the Board are plan fiduciaries. The members of the Board have a duty to prudently select and monitor the appointed fiduciaries. As appointed fiduciaries, the members of the plan committee have a duty to prudently perform their tasks. Typically, those tasks include overseeing the administration and investment of the plan.

In this case the CFO is a member of the Board and the plan committee. Thus, in each case, the CFO is a fiduciary "to the extent" of the responsibilities of the particular position. So the CFO, as a member of the Board has the responsibility to prudently select and monitor the appointed fiduciaries. In addition, the CFO, as a member of the plan committee has the responsibility to prudently perform the tasks of the committee.

[9] 29 C.F.R. § 2509.75-8, D-4.

I'm a Fiduciary

PRACTICAL TIP

In this example, the Board has a responsibility to oversee the operation of the plan at a reasonable level. What that means is that the Board does not have to do the work of the committee, but it needs to make sure that the committee is doing its work in a way that can reasonably be expected to be proper and prudent. The committee can assist the Board in performing its oversight function by providing the Board with an annual report of its activities.

Trustee

A trustee holds the legal title to the plan's assets in a trust for the benefit of the participants. A trustee is always a fiduciary. It must hold and protect the plan's investments.[10] It must also diligently carry out the directions of the committee and the plan sponsor regarding operation of the plan and the investment choices made by the participants to the extent those directions are consistent with the plan document. In other words, if the plan sponsor directs the trustee to do something, but it does not have the authority to do so, the trustee cannot accept that direction. The trustee has exclusive authority and discretion to manage and control the plan money unless the trustee is subject to the directions of another plan fiduciary (for example, the committee) or the participants. In those cases, the trustee is referred to as a "directed trustee," and the trustee's discretion and liability are limited.[11] For most 401(k) plans, the trustee is directed by the plan committee (which is appointed by the sponsor of the plan) to offer a specified lineup of investments to the participants and to accept the participants' directions about investing their money in those choices.

Most small companies' plans are self-trusteed. That means that the directed trustee of the plan usually is an officer of the company.

[10] ERISA § 403(a).
[11] DOL Field Assistance Bulletin 2004-3 at http://www.dol.gov/ebsa/regs/fab_2004-3.html.

DIRECTED TRUSTEE

Acme Company's Trust document names the President of the Company as the Trustee of the Plan. The Trust document does not give the Trustee discretion to manage and control the plan money. Instead, the President, as the Trustee of the Plan is subject to the direction of the Plan Committee.

Who are the trustees?

The Acme Company Plan is a self-trusteed plan and the President is a directed trustee.

As a directed trustee, the President's most basic duty is to follow the directions of the Plan Committee. However, the President also has a duty to protect the interests of the participants (see Legal Descriptions of a Fiduciary and My Fiduciary Responsibilities for a more thorough discussion of this duty). In other words, as a directed trustee, the President would have some obligation above and beyond just accepting the directions of the plan sponsor and making sure that they were consistent with the plan documents.

For example, the trustee has a duty to make sure that the trust collects all of the deferrals from the plan sponsor on a timely basis. In satisfaction of this obligation, the trustee would have the responsibility to gather all the plan assets, including deferrals, and to make sure that they are appropriately protected. In addition, the trustee would have the fiduciary duty to follow the terms of the plan document and the trust document to the extent that those terms discuss the trustee's responsibilities.

I'm a Fiduciary

PRACTICAL TIP

In order for the President to be fully aware of his duties and obligations as a trustee, the President should review the plan and trust document (or have a competent person review them and explain his responsibilities) in order to understand his responsibilities.

In addition, as the trustee, the President should ensure that the people who handle the plan money at the company are bonded so that the trust (and the President as trustee) are protected against any embezzlement of deferrals (see Limiting My Liability for a more complete discussion of the importance of liability insurance and bonding).

Investment Advisers

A person or firm that renders investment advice to a plan for compensation is a fiduciary, but only for that purpose. Plans sometimes hire investment advisers to assist them in selecting and monitoring the funds to be offered to the participants. In that case, the selection of the investment adviser is a fiduciary act, and the fiduciary responsible for selecting the investment adviser must prudently select and monitor the investment adviser. The investment adviser is accountable for meeting the fiduciary standards for providing investment advice, but is not responsible for other activities of the plan. However, the adviser is a co-fiduciary and could have additional legal responsibilities beyond its defined role (see “My Fiduciary Responsibilities” [“Co-Fiduciary Responsibility”] for a more complete discussion of co-fiduciary responsibility).

INVESTMENT ADVISERS

The committee of the Acme Company 401(k) Plan hired XYZ Capital to provide the committee with advice on the initial selection and ongoing monitoring of the plan investments. Acme Company pays XYZ Capital a set fee for its services.

Who is the investment adviser?

By providing investment advice to the plan committee for a fee, XYZ Capital is a fiduciary investment adviser.

As a fiduciary investment adviser, XYZ Capital is responsible for meeting ERISA’s fiduciary standards. For example, XYZ Capital must engage in a prudent process to develop and deliver its advice and must act for the exclusive purpose of providing retirement benefits for participants. However, XYZ Capital is only a fiduciary to the extent of its advice to the plan committee.

In retaining the services of an investment adviser, the committee is responsible for prudently selecting and monitoring XYZ Capital. In addition, the committee needs to review the advice of the investment adviser before they accept it. In other words, the committee cannot just rubberstamp XYZ Capital’s advice.

I'm a Fiduciary

PRACTICAL TIP

Annual Report: The plan committee should require that the investment adviser give the committee—at least annually—a written monitoring report which describes the adviser's processes, the results of the adviser's work in the past year, the fees charged by the adviser (including an explanation of how the fees are competitive in the marketplace) and information about the continuing qualification of the adviser. The committee should review the information and, if appropriate, formally approve it.

Fiduciary Status: The committee should have a written agreement with the investment adviser. In that agreement, the adviser should acknowledge that it is a fiduciary under ERISA for purposes of its investment advice. Under the Department of Labor's (DOL) 408(b)(2) regulation, almost all investment consultants are required to give disclosures to plans about their services/fiduciary status, and compensation (from all sources related to the plan). If the disclosure doesn't say that the adviser/consultant is a fiduciary, then he's not (or at least he is taking the position that he isn't). Plan sponsors and committees should consider whether having fiduciary advice is important to them.

Who is Not a Fiduciary

A "settlor" is someone who sets up a plan or trust. The company, as the plan's "settlor" or founder, is not a fiduciary (and may act in its own best interest) when deciding whether to have a plan, how to design the plan, and whether to terminate it. On the other hand, as a fiduciary, the company must make decisions in the best interest of the employees. Because of these rules, in the design, creation or termination of a plan, the company is acting as a settlor and can make decisions about what's best for the company. However, once the plan is designed and created, the company is a fiduciary for implementing the plan's provisions… therefore, the decisions must be made in the best interests of the employees.

A "settlor" function is an action or decision made by a plan sponsor, as opposed to a decision by a fiduciary. However, in the real world, that distinction is not always clear. In some cases, the company will be a settlor and in others it will be a fiduciary. But the difference is important because settlor decisions are not governed by the fiduciary provisions of ERISA. Examples of settlor activities are the creation and design of a plan and the termination of a plan.[12]

By definition, a fiduciary must have authority or control over the operation of the plan or the plan's investments. Under a regulation issued by the DOL, making individualized "recommendations" with respect to plan investments or management constitutes fiduciary investment advice.[13]

But many routine or "ministerial" jobs in operating a plan are not fiduciary activities, since the details of the work are specified by the law or the plan, and little discretion is involved. For example, the following are not fiduciary activities:

- the calculation of benefits following the rules in the plan document;
- applying clear rules in the plan for determining eligibility to participate;
- maintaining records and preparing reports and government filings;
- preparation of employee communications material;

[12] DOL Advisory Opinion 97-03A.
[13] DOL Reg §2510.3-21.

Non-fiduciary activities (continued):

- maintenance of participants' service and employment records;
- orientation of new participants and advising participants of their rights and options under the plan;
- collection of contributions and application of contributions as provided in the plan;
- preparation of reports concerning participants' benefits; and
- processing of claims.[14]

Thus, individuals who perform clerical or ministerial administrative duties for the plan, but who do not make decisions about plan investments, policies, or interpretations, are not fiduciaries.[15] For example, third party administrators, plan providers, actuaries, accountants, and lawyers performing their professional duties usually are not fiduciaries.[16] In our review of the materials related to the services provided by CUNA Mutual Group, they are performing the traditional role of a recordkeeper and third party administrator, which are not fiduciary activities.

In cases where an individual or entity acts in both fiduciary and non-fiduciary capacity, for example, plan sponsors and their officers and directors, it is important for them to understand when they are acting in each capacity, so that they can make decisions according to the applicable standards. For example, in deciding whether to establish or terminate a plan, the Board of Directors owes fiduciary duties to the shareholders under corporate laws. But in making these decisions, they do not owe a fiduciary duty to participants under ERISA. However, in implementing the plan, the directors and officers owe fiduciary duties to the employees. If they don't understand what the duty is and to whom it is owed, it is very difficult to comply with the law.

[14] 29 C.F.R. § 2509.75-5, D-1.
[15] 29 C.F.R. § 2509.75-8, D-2.
[16] 29 C.F.R. § 2509.75-5, D-1.

My Fiduciary Responsibilities

Now that you know you are a fiduciary, here are some guiding principles to help you succeed.

1. Fiduciaries should always act with the duty of loyalty to the participants. That is, they should look out for the best interest of the participants over any other competing interest, including any interest that the company may have or that the plan committee members may have individually.
2. Fiduciaries should always act for the exclusive purpose of providing retirement benefits. While the plan committee can consider other issues and features that might make the plan more attractive in a variety of ways, none of those alternatives can override the requirement that the fiduciaries act for the exclusive purpose of providing retirement benefits.
3. Fiduciaries must always engage in a prudent process. “Prudent process” is described more thoroughly in the “Prudent Man Rule,” but the key steps are: the gathering of the information needed to properly evaluate the issue; the review and discussion of that information by the committee members; and making an informed and reasoned decision based on the information reviewed. If the fiduciaries do all of that, then almost inevitably they will have fulfilled their duties under the law and under the terms of the plan.

The Prudent Man Rule

Fiduciaries must act prudently. That is, fiduciaries must use the care, skill, prudence and diligence that an experienced and knowledgeable person would use in the same situation. It is the standard of care that governs all fiduciary decisions.

The fiduciary standard of care only applies to fiduciary activities. Although this may seem like a statement of the obvious, it is important to understand this concept because certain activities are not considered "fiduciary activities." Both the courts and the Department of Labor recognize that some decisions, such as designing a plan and deciding on plan terms such as eligibility or benefits, are "settlor activities." Settlor acts are not subject to ERISA's fiduciary rules.

To be prudent, you have to be careful in what you do. To fulfill your duties, you need the skills of a person who is knowledgeable and experienced in similar matters, *i.e.*, managing a retirement plan, and not just those of an ordinary person. This is sometimes called the "prudent expert rule." (However, where the committee members do not have the expertise needed to make a prudent decision, they can use their advisers and providers to obtain that information and analysis.)

Finally, you have to be diligent in your actions—which means paying attention to your duties and performing them in a thorough, thoughtful and timely way.

This standard goes beyond good faith. In fact, one court has said that "a full heart and an empty head" are not enough to satisfy ERISA's fiduciary requirements. It requires action appropriate to the situation. Prudence means that you have considered all the material facts and circumstances that you know—or should know—are relevant to each decision.

A Prudent Process

The requirement to act prudently in administering a retirement plan has two parts: the conduct required of the fiduciaries and the results they are expected to achieve. The dual obligations under the prudence requirement were described in an opinion written by then Circuit Judge, now Supreme Court Justice, Antonin Scalia: "In short," he said, "there are two related but distinct duties imposed upon a trustee: to investigate and evaluate investments and to invest prudently."[17] Those dual obligations under the prudence requirements are referred to as

[17] *Fink v. National Savings and Trust Company*, 772 F2d 951, 962 (D.C. Cir. 1984)

procedural prudence, which is the process of investigating, deliberating and deciding, and substantive prudence or the duty to review the “substance,” the right information, and to make an informed and reasoned decision.

Procedural Prudence: “Procedural prudence” focuses on the work the fiduciary did in making the decision, rather than on the results. To satisfy the requirement to engage in a “prudent process,” the fiduciary must gather the right information, review it in the right way, and make the right kind of decision (that is, an informed and reasoned decision). This process applies to fiduciary duties, such as selecting investments, choosing the firm to provide administrative services to the plan, and so on. Once a decision is made, though, the fiduciary must monitor the performance of the investments and the plan providers and remove and replace them if the performance is not acceptable.

For example, to engage in a prudent process for selecting investments, you must perform an investigation of the investments in order to select appropriate investments to be offered to the participants. In doing this, it is important to be careful and diligent in gathering and assessing the information. You would expect the results to be favorable if you are diligent, but it is impossible to know to a certainty how an investment will perform in the future. As a result, the focus is on the process and not on the ultimate outcome. Thus, “procedural prudence” requires that you go through the right decision-making process, but it does not make you a guarantor of the results.

Remember, the emphasis is on the process, rather than the result. Although you can’t be expected to pick the “best” investments every time, you are responsible for following a prudent process every time you make a decision. No one can predict the future. The duty of a fiduciary is to conduct a prudent, independent investigation, not to necessarily achieve the best possible result. You cannot be faulted for an inferior investment return if the selection and monitoring process were conducted, and documented, in a prudent manner.

PROCEDURAL PRUDENCE

Got it Wrong: Acme Company sponsors a 401(k) plan but its Board of Directors (the "Board") does not appoint a plan committee. As a result, even though the plan sponsor was given information about the investments from the provider, that information was not closely reviewed and no decisions were made.

Over a period of time, the quality of some of the investments deteriorated and, as a result, the plan participants made less money than they would have, even if they had average-performing funds in place of the inferior funds.

Result: A breach of fiduciary duty, because there was no process, much less a prudent process. The fiduciaries are liable for the loss as a result of their breach; inferior earnings are considered losses under ERISA. So, in this case the measure of damages will be the difference between earnings on prudently selected investments and the earnings on the inferior investments.

Got it Right: Acme Company sponsors a 401(k) plan. Acme Company's Board appoints a plan committee, consisting of the Vice President of Human Resources, as chairperson, the CFO and a benefits manager. The plan committee meets quarterly on a regular basis and a plan provider provides detailed information to the plan sponsor about the investments, the committee members review the information and discuss it at the meetings. As it turns out, the CFO is highly knowledgeable about investments and mutual funds and adds significant contributions about how to interpret the data received from the provider and about the quality of the various mutual funds.

Result: By analyzing the data and with the input from the CFO, the committee was able to recognize mutual funds where the quality of management had deteriorated, including manager turnover, and replaced those funds on a timely basis. In addition, with the CFO's input, the plan committee selected, where appropriate, low-cost index funds which provided both superior performance and low cost for the participants.

My Fiduciary Responsibilities

Substantive Prudence: To make a reasoned decision, the fiduciary's decision must be based on their investigation and evaluation process, that is, it must be a logical and reasonable decision based on the information reviewed—and the information reviewed must be that which the fiduciaries actually knew, or should have known, was relevant to their decision.

When applied to investment decisions, a fiduciary should:

- know what information is relevant to the decision, *i.e.*, the information needed to be evaluated to make a prudent and informed decision;
- accumulate the information relevant to making the specific decision;
- evaluate and make appropriate judgments about the "relevant" information (including using competent advisers and providers to assist in that evaluation); and
- make a prudent decision.

Not everyone who becomes a fiduciary is an expert in running a retirement plan or selecting investments. The DOL, as well as a number of courts, has taken the position that, if the fiduciaries are not adequately qualified to fulfill certain aspects of their duties, they are required to seek help.[18] ERISA permits fiduciaries (indeed, sometimes requires them) to rely on third parties, who may include both experts that are fiduciaries and providers that are not fiduciaries, in fulfilling their duties.

Fiduciaries are not required to have the same level of expertise as their consultants or to duplicate their work. However, the courts make it clear that the fiduciaries have an obligation to continue to exercise judgment and may only rely on an expert that is qualified. Indeed, the fiduciaries must still reasonably review, understand and approve the advice.

[18] 29 C.F.R. §2509.95-1(c)(6); *Martin v. Feilen*, 965 F.2d 660, 671 (8th Cir. 1992).

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My Fiduciary Responsibilities

PRUDENT PROCESS

Without help, it is difficult for most employers and fiduciaries to conduct meaningful investigations of their 401(k) plans, to evaluate the information developed in the investigation, and to determine the solutions for the problems that are identified. Because of that difficulty, fiduciaries should make sure that their providers and advisers offer meaningful support services and should use those provider or adviser services. On the other hand, if the fiduciaries want to do the selection and monitoring themselves, they would benefit from the practical tips below.

PRACTICAL TIPS FOR SELECTING AND MONITORING INVESTMENTS

Investment Review:

In addition to the information offered by the provider, the plan committee can utilize the commercial services that are available, on a subscription basis, for reviewing mutual funds. The committee could subscribe to those services and delegate one of its members to be the person responsible for putting together copies of the materials concerning the mutual funds included in their plan, as well as possible replacement funds for investments that needed to be removed.

Reviewing the Material from Provider:

In reviewing the materials from the provider and subscription services, the committee should analyze both the qualitative material (such as investment management turnover) and the quantitative material (such as expense ratios, past performance—particularly for the most recent three- and five-year periods, etc.), and should compare that information to both the appropriate indices and to other funds within the peer group. (A peer group is the group of comparable funds, for example, U.S. Small Cap Value Funds, International Large Cap Core Funds, and so on, of the mutual fund being reviewed.)

Reviewing Expenses:

The plan committee should periodically gather and evaluate information about the cost of other investments and services in the marketplace. To do that job, the committee needs to know about the expenses currently being paid for the investments and services and would need to compare those costs to those for similar investments and services.

The Duty of Loyalty

The ERISA duty of loyalty provides that a plan fiduciary must act "solely in the interest" of the plan and its participants and beneficiaries. Thus, a fiduciary must act with an "eye single" to the interest of the participants (and of providing retirement benefits for the participants) and must not put the interests of a third party (for example, personal interests or the interests of the Company) before the interests of the participants.[19]

This means that all your actions as a fiduciary must be performed with complete and undivided loyalty to the participants.

CASE STUDY

The Acme Company committee is in the process of selecting an investment adviser for the plan. The chairperson of the committee suggests that the plan committee select XYZ Capital as the plan's investment adviser. Unbeknownst to the other committee members, XYZ Capital has offered the chairperson a discounted fee for advising on his personal investments if it is selected as the adviser for the plan.

The Law: As a fiduciary of the plan, the chairperson owes a duty of loyalty to the participants. In addition, a fiduciary cannot cause the plan to enter into a transaction that would directly or indirectly benefit him.

Result: The chairperson has breached his fiduciary duty and caused the plan to enter into a prohibited transaction. (See "Avoiding Prohibited Transactions" for a complete discussion of prohibited transactions). The value of the benefits the chairperson received (that is, the discount) belongs to the plan.

[19] *Donovan v. Bierwirth*, 680 F.2d 263 at 271.

The Exclusive Purpose Rule

The plan must be maintained for the "exclusive benefit" of the participants and their beneficiaries. ERISA describes this as the duty to act "for the exclusive purpose of: (i) providing benefits to participants and their beneficiaries; and (ii) defraying the reasonable expenses of administering the plan."[20]

Thus, the focus of the exclusive purpose rule is on *retirement income*. As such, the fiduciaries must make all decisions, including the selection, monitoring and disposal of investments, for the exclusive purpose of providing retirement benefits, or income. So long as the fiduciary's focus is on retirement benefits, if the fiduciary engages in a prudent process, in almost all cases, the exclusive purpose rule will be met.

This means that, when acting as a fiduciary, you should always keep your eye on the interests of providing quality retirement benefits for the participants.

CASE STUDY

A member of the Acme Company committee would like to include a hot mutual fund that he heard about from a friend in the plan's line-up of investments, so he can invest in it. The mutual fund performed extremely well in the last year, but was very volatile.

Rule: The job of the committee members is to determine what is best for all the participants—for the purpose of providing benefits at retirement, and to decide whether a particular investment is appropriate for the plan as a whole.

Possible Outcome: The volatility and the recent hot performance could lead to substantial losses by the less sophisticated participants who did not know how to properly use that type of investment. If it was determined that, if fiduciaries had engaged in a prudent process they would not have selected that investment for the plan, the committee members may be personally liable for the losses suffered by the participants.

[20] ERISA § 404(a)(1)(A).

Allocating and Delegating Duties

In a retirement plan, there can be different fiduciaries who have different duties for the plan. In most instances, the fiduciaries' skill sets will not be the same—it is appropriate to allocate duties among the fiduciaries based on their interests and abilities.

The plan sponsor is the primary fiduciary. Acting through its board of directors, the company appoints the key fiduciaries… the trustee, the members of the plan committee, and any officers with authority over the plan. In appointing the key fiduciaries, the board has to act prudently in making its selections, taking into account the responsibilities of the positions and the abilities of the people they appoint. The board also has a duty to monitor their performance, to make sure they do a good job and continue to do a good job for the plan and its participants.

The committee typically has two jobs: the duty to oversee the proper administration of the plan and the prudent selection and retention of the investments offered to the participants. (In some plans—usually large ones, there may be two committees, one responsible for the selection of investments and another for the administrative operations.)

Plan committees may get help by hiring outside experts, generally where the committee members are not knowledgeable about the issues involved in investments or administration. Some of the experts are also fiduciaries, such as investment advisers whose duties may include recommending the investment options, assisting with preparation of the plan's investment policy, advice on monitoring investments, recommending changes and the like. Other individuals are not fiduciaries, such as attorneys, accountants, plan providers, recordkeepers and administrators when their roles are limited to drafting and reviewing documents, completing and filing government forms, keeping track of participant account balances, and processing distributions. For all of these jobs–both fiduciary and non-fiduciary, the committee has the duty to make sure that those hired are properly filling their roles and to replace anyone who is not performing properly.[21]

[21] 29 C.F.R. §2509.75-8 D-4.

In fact, in situations where the committee is not qualified to fulfill its duties, it is required to seek help.[22] In situations where fiduciaries retain the services of experts, they may not rely blindly on the advice they receive. Instead, they must review, evaluate and understand the advice, and then decide whether to accept and implement it.[23] However, fiduciaries are not required to have the same level of expertise as their consultants or to duplicate their work.[24]

PRACTICAL TIP: RETAINING THE SERVICES OF AN INVESTMENT EXPERT

Although fiduciaries are not obligated to duplicate the work of the experts they retain, they are responsible for reviewing and understanding the expert's advice. Also, where fiduciaries retain the services of an adviser for selecting investments, the adviser is required to make a written disclosure to the fiduciaries about its services, fiduciary status and compensation from all sources. (This is sometimes called the 408(b)(2) regulation.)[25] The committee is required to evaluate those disclosures in addition to reviewing the adviser's credentials and understanding the process the adviser uses for selecting and monitoring the investments. Finally, the fiduciaries should require regular written reports concerning the selection and monitoring of investments.

[22] 29 C.F.R. §2509.95-1(c)(6).
[23] *Donovan v. Mazzola*, 716 F.2d 1226 (9th Cir. 1983).
[24] As the court in *In re Unisys Sav. Plan Litig.*, 74 F.3d 420, 435 (3d Cir. 1996) said, "we would encourage fiduciaries to retain the services of consultants when they need outside assistance to make prudent investments and do not expect fiduciaries to duplicate their advisers' investigative efforts…"
[25] 29 C.F.R. §2550.408b-2.

Selecting and Monitoring Service Providers

It's difficult, if not impossible, for fiduciaries to operate their plans without the help of knowledgeable service providers. Help is needed in complying with the law's technical requirements, selecting investments, providing daily recordkeeping, handling participant investment changes, preparing required government reports, drafting participant information and disclosures, and on and on.

However, fiduciaries are not expected to do all of that work. Instead, they can hire competent and qualified service providers for those jobs. As examples, fiduciaries often hire recordkeepers (providers), advisers or consultants, and/or third party administrators for their plans. But, the hiring and oversight of those service providers is a fiduciary function and must be done prudently.[26]

The prudent selection of service providers involves the consideration of their services and experience, the cost of those services and any conflicts of interest. Fortunately, a DOL regulation[27] (the 408(b)(2) regulation) requires that most service providers give fiduciaries written disclosures of their services, fiduciary status and compensation. (The compensation disclosure includes any payments the service providers receive from the investments or other providers or advisers. In other words, financial conflicts of interest must be disclosed.)

Then, the fiduciaries must decide whether the quality and types of services are right for their plan and participants and whether the cost is reasonable.[28]

[26] Tips for Selecting and Monitoring Service Providers for Your Employee Benefit Plan, Employee Benefit Security Administration (EBSA), U.S. Department of Labor.
[27] 29 C.F.R. §2550.408b-2.
[28] See, DOL Advisory Opinions 97-15A and 97-16A.

My Fiduciary Responsibilities

After the service providers have been hired, the fiduciaries must regularly monitor them to make sure they perform their jobs properly, continue to be qualified, and charge no more than reasonable amounts for their services. (NOTE: Participant complaints can be valuable for determining whether a provider is falling down on the job.)[29]

While fiduciaries will usually know if their service providers are doing their jobs, it is harder to know if their total compensation is reasonable. That's why it's important to have industry data to compare (or "benchmark") the costs and compensation of the plan providers.

Since the pricing of plan services can vary based on plan size (and sometimes on number of participants), a plan's cost and provider compensation should be compared to similar, or "peer," plans. If it turns out that a provider's compensation is more than a reasonable amount, the level of compensation should be re-negotiated. While there isn't a specific rule about how often costs and compensation should be benchmarked, a common rule of thumb is to do it every three to four years.

[29] See, *e.g.*, DOL Field Assistance Bulletin 2007-01.

Selecting and Monitoring Investments

The purpose of a retirement plan is to enable participants to accumulate funds for their retirement. The job of the fiduciaries is to help them do so. In carrying out that job, the fiduciaries must prudently select the plan's investments. The test for prudence is whether the fiduciaries gave appropriate consideration to the facts and circumstances that they knew or should have known were relevant to the particular investment.

In describing the obligations of fiduciaries, courts have said that fiduciaries must monitor and dispose of investments which are improper to keep.[30] So, in addition to selecting the initial investments, the fiduciaries have an ongoing duty to periodically review the investments offered by the plan and to decide whether their initial decisions remain valid or whether they need to remove and replace any of the plan's investments.

There are two jobs for fiduciaries (such as a plan committee) in performing this task. The first is to select a broad range of investment alternatives in order to enable the participants to construct portfolios in their accounts which properly balance risk and reward for each participant—at least within reason. The second is to then select investments within each of the categories that are chosen for the purpose of the first step. So, for example, fiduciaries may decide to have, among others, a Large Cap Value Fund and a Large Cap Growth Fund. The fiduciaries would then, as a second step, need to pick a prudent mutual fund for each of those categories. Most plans select at least a U.S. Large Cap Core Fund, a U.S. Large Cap Value Fund, a U.S. Large Cap Growth Fund, a Small or Mid Cap Value or Core Fund, an International Stock Fund, an Intermediate Term Bond Fund or a Multi-Sector Bond Fund, and a Cash or Stable Value option. In fact, most plans select more options than that, but they almost all have at least those categories. In addition to selecting the various asset classes to offer, the fiduciaries should consider what share class to offer for a particular fund (*i.e.*, retail versus institutional shares) as there are cost differences among different share classes (even though the investment portfolio is the same).[31]

[30] *Morrissey v. Curran*, 567 F.2d 546, 548-49 (2d Cir. 1977).
[31] See, *e.g.*, *Tibble v. Edison International,* No. CV 07-5359, 2010 WL 2757153 (July 8, 2010 C.D. Cal.); 729 F.3d1110 (9th Cir. 2013).

PRACTICAL TIP

In deciding what features to choose for its plan, an employer should determine the approach that it wants to take to managing its plan. For example, before a company selects an “open architecture” platform, it should determine whether it has the internal knowledge and skills to take on that approach and/or whether it is willing to hire the outside resources to handle the increased complexity and responsibility of open architecture.[32]

[32] An “open architecture” platform is one where the plan has access to thousands of funds of differing quality and costs (as opposed to where a provider is offering a more limited line-up of, *e.g.*, 100 or 200 funds that qualified). Obviously, it takes more expertise to oversee an open architecture platform.

PRACTICAL TIP

In making their investment decisions, fiduciaries must consider generally accepted investment theories, including the modern portfolio theory, and prevailing investment industry practices. By "generally accepted investment theories," we are referring to the fundamental principles underlying modern concepts of investing. These include the modern portfolio theory and strategic asset allocation - looking at an investment portfolio as a whole and taking into account diversification within the portfolio.[33] "Prevailing industry practices" refers to the techniques that investment managers and advisers use in applying generally accepted investment theories, such as the quantitative and qualitative measures that are used to judge the quality an expected future performance of various investments.

If fiduciaries do not have a grasp of these theories and principles, it will be difficult, if not impossible, for them to prudently select and monitor the investments to be offered for participant direction. For example, for participant-directed plans, fiduciaries must select a variety of investment categories (or "asset classes," as they are called by investment specialists). The number and types of investments must be adequate to allow participants to use those investments to properly balance risk-and-reward according to their needs.

[33] See, *e.g.*, *Laborers Nat'l. Pension Fund v. Northern Trust Quantitative Advisors, Inc.*, 173 F.3d 313 (5th Cir. 1999); *Lanka v. O'Higgins*, 810 F. Supp. 379 (NDNY 1992); *Jones v. O'Higgins*, 11 EBC 1660 (NDNY 1989).

Holding Plan Assets in Trust

Plan assets must be held in trust, which means that they must be held separately from the other assets of the employer or others who deal with the plan. When an asset becomes a plan asset, it must be separated from the employer's assets and given to the trustee for safekeeping as soon as it can reasonably be done. The reasons for this rule are obvious. First, no one else should be able to access those funds—especially creditors of the employer or even the employer itself—because the assets are for the exclusive purpose of providing retirement benefits to participants. Similarly, when the plan purchases investments with its funds, they must be registered in the name of the trust and held by the trustee.

The prudence rules for investing require that the money contributed to the trust be invested as soon as possible to begin earning for future retirement benefits. Consider participant deferrals to a plan. A participant directs the employer to take a part of his or her paycheck and put it into the plan. As soon as the employer is able to remove that deferral money from its general assets, it becomes a "plan asset" (even if it is still held by the employer). Once the deferral is a "plan asset," it must be put into the trust immediately. (See discussion in "Timing of Deferral Deposits" within the "Compliance Issues" section.) The failure to put deferrals into the trust in a timely manner is a potential breach of fiduciary duty and a prohibited transaction. (See discussion in "Examples of Fiduciary Violations"). In order to help ensure that contributions are made, the plan fiduciary responsible for selecting the plan's trustee(s) must appropriately assign the duty to monitor and collect contributions.[34]

[34] DOL Field Assistance Bulletin 2008-01.

Following Terms of Plan

The law governing retirement plans—in combination with the provisions of the plan document—contain the rules a fiduciary must understand in order to fulfill his fiduciary duties. The plan and trust documents describe how the plan is to be operated and contain provisions the fiduciary must follow in administering the plan and managing its investments.[35] (But, on the rare occasion where following the plan provisions would be a breach of the fiduciary rules, the fiduciary must follow the law.)

You need to know the plan provisions, as well as the law, in order to fully understand your responsibilities and to successfully fulfill those responsibilities. This means you need to read and understand the plan document…[36] and you need to follow the terms of the plan *unless* it would not be prudent to do so. In other words, the only time you can justifiably fail to follow the terms of the plan is when it would violate the prudent man rule to do so, for example, if it would expose participant investments to undue risk.

Finally, it is possible that there will be an ambiguous provision that needs to be interpreted no matter how carefully a plan document is drafted. Ambiguities should be interpreted by the fiduciary who has that responsibility under the terms of the plan. Usually, that is the plan committee. Most plan documents give broad discretion to the responsible fiduciary to interpret the plan. That discretion must be used in a fair, consistent, and nondiscriminatory way. Read the plan carefully; learn all the important facts; consult with the plan's lawyers and possibly other advisers; review the information in a thoughtful and deliberate manner; and then make the decision.

[35] ERISA § 404(a)(1)(D).
[36] A fiduciary must discharge his duties "in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions" of ERISA. ERISA § 406(a)(1)(D).

My Fiduciary Responsibilities

PRACTICAL TIP

It is important to know what the plan provides and to follow those rules. Otherwise, without knowing it you could violate the fiduciary rule that requires you to follow the terms of the plan.

- The committee should review the plan document as well as the summary plan description.
- If there are provisions of the plan that the committee does not understand, the committee should consider having someone meet with them to explain those provisions.
- The committee should never make a decision without reviewing the provisions of the plan or trust document that are involved in that decision.

FOLLOWING THE TERMS OF THE PLAN

The following examples illustrate some common areas where plan sponsors fail to follow the terms of the plan.

Matching Contributions:

The Acme Company plan document provides that company matching contributions are to be deposited to participants' accounts on a payroll-by-payroll basis. Even though there are other ways to make matches, it would violate the terms of the plan to deposit the match less frequently.

Plan Loans:

A participant in the Acme Company plan takes a third loan from her plan account. She is still paying off her previous two plan loans. The plan committee approves the loan. The Acme Company's plan document limits the number of loans that a participant can have at one time to two. The loan limitation was inadvertently exceeded because the committee was not familiar with the provisions in the plan document.

Employee Classification:

The Acme Company plan document provides that all common law employees are entitled to participate, but excludes independent contractors. The human resource department mis-classifies a new employee as an independent contractor, but he is really an employee and, therefore, is entitled to participate in the plan.

Hardship Withdrawals:

The Acme Company plan provides that hardship withdrawals may be made for the following permissible reasons: a) medical expenses incurred or anticipated to be incurred by the employee, the employee's spouse or dependent;[37] b) the purchase (excluding mortgage payments) of a principal residence of the employee; c) tuition and related educational fees for the next 12 months for post-secondary education for the employee, spouse, children or dependents;[37] d) payment to prevent eviction from the employee's primary residence or foreclosure on the mortgage on the employee's primary residence; e) to make payments for burial or funeral expenses for your deceased parent, spouse, child or dependent; and, f) to pay expenses for the repair of damage to your principal residence. One of the participants requests a hardship withdrawal from the plan to pay for his mortgage on his vacation home. The committee approves the hardship withdrawal, and thereby violates the terms of the plan.

[37] Plans are also permitted to allow hardship withdrawals for medical or tuition expenses of the participant's beneficiary. In order to allow this, the plan document must so state.

Maintaining Records

Fiduciaries should maintain records as proof that they did their job. Good records are protection from claims that fiduciaries breached their duties. For example, fiduciaries should maintain a "due diligence" file. That file should include copies of the reports reviewed in selecting funds for the plan and minutes for meetings concerning the operation of the plan and the plan investments. Those minutes should be a complete and accurate report of what transpired at any meetings including any issues considered, decisions made, presentations made and who was present.

A "due diligence" file should also be kept for the providers hired to help the fiduciaries with their duties. The records should show the fiduciaries' inquiry into the provider's qualifications and experience, as well as ongoing monitoring of their performance.

PRACTICAL TIPS

Retention of Records: Plan records should be kept for at least 6 years. Records of the calculation or vesting of participant benefits should be maintained until at least 6 years after the benefits are distributed.

Due Diligence File: The plan should have a due diligence file for the selection of each provider and adviser, including all of the information reviewed (such as the 408(b)(2) disclosure and any information about the evaluation of their compensation) and the contract with the provider.

In addition, the plan should have a separate due diligence file for each plan year for the ongoing monitoring of the operation and investments. The documentation for the investments should include information about the investment expenses and the revenue sharing paid to the plan and the service providers.

The committee minutes summarizing what went on in the meetings, together with a brief cover memo, should be forwarded to the Board of Directors after the end of each year to assist the Board in its responsibilities to monitor the committee.

Reviewing Plan Expenses

Plan money may be used to pay plan expenses that are related to the administration of the plan and authorized by the plan document.[38] Those expenses include costs for activities related to the administration of the plan, the investment of the plan assets, and any services for the plan or for the participants. Expenses that relate to the business activities and decisions of the employer (*e.g.*, expenses for the design of the plan or accounting expenses for the company's financial reports) may not be paid from the plan. It is important to understand what expenses can be paid from the plan, because the improper payment of plan expenses can result in a breach of fiduciary duty and/or a prohibited transaction. This is illustrated by the increased number of lawsuits in the 401(k) world. In the last few years, one mid-western law firm alone has brought over a dozen lawsuits alleging that plan fiduciaries have breached their fiduciary duties due to excessive fees.[39]

In addition to understanding what expenses can be paid from the plan, the fiduciary is also responsible for reviewing the plan expenses to ensure that those expenses are reasonable and appropriate. In a report issued by the Government Accountability Office ("GAO") on 401(k) fees, the GAO stated that "[o]ver the course of the employee's career, fees may significantly decrease retirement savings." To illustrate this point the GAO report provided the following example: "A 1-percentage point difference in fees can significantly reduce the amount of money saved for retirement. Assume an employee of 45 years of age with 20 years until retirement changes employers and leaves $20,000 in a 401(k) account until retirement. If the average annual net return is 6.5 percent—a 7 percent investment return minus a 0.5 percent charge for fees—the $20,000 will grow to about $70,500 at retirement. However, if fees are instead 1.5 percent annually, the average net return is reduced to 5.5 percent, and the $20,000 will grow to only about $58,400. The additional 1 percent annual charge for fees would reduce the account balance at retirement by about 17 percent."[40]

[38] DOL Advisory Opinion 2001-01A at http://www.dol.gov/ebsa/programs/ori/advisory2001/2001-01A.htm; DOL Advisory Opinion 97-3A.
[39] See, *e.g.*,*Caterpillar Settles 401(k) Fee lawsuit* Treasury & Risk (November 17, 2009).
[40] GAO Report *"Private Pensions: Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information on Fees"* (November 2006).

Even within one mutual fund, there may be a significant cost difference between offering retail versus institutional shares. Thus, plan expenses can have a significant impact on the return of plan investments, so fiduciaries should identify all expenses and evaluate whether the expenses are reasonable in light of the services provided.

PRACTICAL TIP

At the annual meeting of the committee, the committee should review the plan expenses.[41] The first step is to get information on all of the expenses paid by the plan. That would include amounts paid to providers and advisers, as well as any expenses related to the investments and any indirect payments, such as revenue sharing. If the committee lacks the ability to gather that information and to evaluate it, the members should work with an adviser who can help them do that.

The expenses should be evaluated in two ways:

1. Are they reasonable for what the plan is getting in return?
2. Are they competitive in the marketplace?[42]

To make these decisions, fiduciaries need to get information about market prices and services, and to compare the market data to their plan costs

[41] DOL Reg 2550.404a-5.

[42] *Tussey v. ABB, Inc.*, 2:06-CV-04305-NKL, 2012 WL *1113291* (W.D. Mo. Mar. 31, 2012) *amended in part,* 06-4305-CV-C-NKL, 2012 WL *2368471* (W.D. Mo. June 21, 2012) *reconsideration denied,* 2:06-CV-04305-NKL, 2012 WL *5512389* (W.D. Mo. Nov. 14, 2012) and *aff'd in part, vacated in part, rev'd in part,* 746 F.3d 327 (8th Cir. 2014).

Disclosing Plan Expenses to Participants

A Department of Labor regulation requires that plan sponsors disclose plan fees and expenses to participants and beneficiaries.[43] The disclosures must be made to all eligible employees, even if they have not elected to participate, as well as beneficiaries who have the right to direct investments (*e.g.*, alternate payees). The regulation is part of the Department of Labor's plan to create transparency for investment and service fees borne by retirement plans and their participants.

As part of those disclosure requirements, plan administrators are required to provide initial, annual and quarterly descriptions of plan-related features, investment alternatives, direct and indirect administrative fees, and participant-level fees. When the DOL refers to "plan administrators," it means the fiduciaries, such as the committee members, who make decisions about plan administration—and does not mean third party service providers who do the calculations and paperwork. However, those service providers offer valuable support to fiduciaries in satisfying these disclosures.

PRACTICAL TIP

While much of the required information is already being provided to participants, plan administrators will need to work with their third party administrators and recordkeepers to make sure all required information is disclosed and that the initial, annual and quarterly notice obligations are met.

[43] 29 C.F.R. § 2550. 404a-5.

My Fiduciary Responsibilities

In addition to the information about investment expenses, participants must also be given disclosures about administrative and individual expenses paid by the plan and charged to participant accounts. ("Administrative" expenses are costs of operating the plan, such as recordkeeping or adviser expenses, that are paid from participant accounts. "Individual" expenses are charges incurred by participants because of a transaction that a participant initiated, for example, a plan loan. In that case, the fee is charged only to that participant's account.)

The expense information to be given to participants, initially and annually, is:

- Information about any administrative expenses which could be charged to a participant's account (and the actual charges must be shown on each participant's quarterly benefit statement).
- Information about individual expenses (which, if incurred, also must be shown on the participants' quarterly benefit statement.)

Investment Disclosures to Participants

The DOL regulation about participant expense disclosures also requires that investment information be given to participants.[44] That requirement is placed on by plan sponsors in their role of administrative fiduciaries. Those disclosures must be given to all participants before they first become eligible to direct their investments and annually thereafter. It's important to note that the DOL definition of "participant" is broader than most people think. It includes all eligible employees (even if they don't have account balances), as well as former employees and beneficiaries of deceased employees, if they still have money in the plan.

The required information includes:

- General information about the plan's investments, how to access them, how to make changes, and any restrictions on making or changing investments.
- Detailed investment-related information. This includes information about the types of investments in the plan, their expense ratios and performance history, investment benchmarks, any conditions or restrictions, and so on. This information is usually included in a participant handout called the "Investment Comparative Chart."

[44] 28 C.F.R. §2550.404a-5.

My Fiduciary Responsibilities

In addition to those written materials, plans must also provide participants with an internet website that also describes:

- Each investment fund's objectives, goals, principal strategy and risks (and the general types of assets held by the fund).
- The turnover rate for each fund.
- Quarterly updates on investment performance for each fund; and
- Each fund's fee and expense information.

Also, participants must be given a general glossary of investment terms and a notice of additional information that can be requested (such as prospectuses and a list of fund holdings).

Fortunately, even though the plan fiduciaries have the legal obligation for these materials, their service providers—and particularly the recordkeeper—actually prepare these detailed and comprehensive disclosures and maintain and update the website.

Co-Fiduciary Responsibility

Even if you do a good job with your duties, you may be responsible for the acts, or the failure to act, of other fiduciaries. This is referred to as "co-fiduciary liability." For example, you can be responsible for other fiduciaries if you:

- knowingly participate in a breach by another fiduciary or even knowingly help conceal an improper act or omission of another fiduciary;
- enable another fiduciary to commit an improper act by failing to carry out your duties; or
- fail to take steps to correct a breach by another fiduciary where you know about the other fiduciary's breach.

So, if you suspect a problem, you need to take steps, and document the steps you take, to protect the participants and the plan. Those steps should include having the committee meet with an experienced ERISA attorney as soon as possible. Further, if there is a potential conflict between the roles of the plan sponsor and the committee, then the ERISA attorney should be an independent attorney, not affiliated with any law firm that represents the plan sponsor.

As an example, this conflict could occur if the plan sponsor stops forwarding deferrals to the plan or if the plan sponsor wanted to borrow money from the plan.

My Fiduciary Responsibilities

CASE STUDY

Co-Fiduciary Liability

Valerie is a member of the Acme Company plan committee. While reviewing plan records she notices that the company is not depositing participant deferrals on a timely basis. She knows that the DOL guidance states that deferrals must be deposited in a timely manner and that the failure to do so is a potential breach, but she does nothing.

The Law: As a fiduciary of the Acme Company plan, Valerie has a duty to protect the participants in the plan. That means she has a duty to take action if she is aware of a breach.

What should Valerie have done? Instead of doing nothing, she should have taken steps to correct the company's breach. For example, she could have informed the other members of the committee of the problem with the company's current practice in dealing with deferrals. The committee members should then work with the company to catch up on the payments and to develop procedures to avoid the problem in the future.

How CUNA Mutual Group Can Help

If fiduciaries lack the knowledge to be able to determine the material information that needs to be reviewed and/or need assistance in evaluating the information, CUNA Mutual Group can help.

Education and Services

- Read and understand this guidebook
- Attend Plan Sponsor and Administrator webinars
- Watch previously recorded webinars

Plan design features

Consider a plan that includes assistance in investment selection and monitoring

1. The Choice plan offers investments that are pre-screened and monitored on an ongoing basis by CUNA Mutual Group's Retirement Plan Investment Committee.
2. The Trustee plan offers a Board of Trustees which accepts co-fiduciary responsibility for investment selection and monitoring.
3. Both options provide research and performance reports supporting the investments in the plan.

Additional Information

[Investment Policy Decisions]
[Implementation of an IPS]
[Concept of a Plan Policy Statement]
[How CUNA Mutual Group Can Help]

Using Investment Policy Statements When Investing Plan Money

The purpose of a retirement plan is to enable participants to accumulate funds for their retirement. The job of the fiduciaries, in this case "investment fiduciaries" (those responsible for the selecting and monitoring the plan's investment options), is to help them do so. In carrying out that job, the fiduciaries must prudently select the plan's investments. The test for prudence is whether the fiduciaries gave appropriate consideration to the facts and circumstances that they knew or should have known were relevant to the particular investment.

In describing the obligations of fiduciaries, courts have said that fiduciaries must monitor and dispose of investments which are improper to keep.[45] So, in addition to selecting the initial investments, the fiduciaries have an ongoing duty to periodically review the investments offered by the plan and to decide whether their initial decisions remain valid or whether they need to remove and replace any of the plan's investments. This is where having an Investment Policy Statement (IPS) and reviewing quarterly investment review reports become very important.

While an IPS is not explicitly required by law, there are legal requirements that fiduciaries make investment policy decisions; having an IPS helps fiduciaries fulfill their fiduciary responsibilities.

[45] *Morrissey v. Curran*, F.2d 546, 548-49 (2d Cir. 1977).

Based on that, there is nearly universal agreement within the retirement plan industry that it is valuable to have a thoughtful and thorough IPS. That is because an IPS helps fiduciaries do a better job of fulfilling their legal responsibilities on a timely and consistent basis.

There are also practical reasons for maintaining an IPS. While it may be possible for fiduciaries to follow a procedure that they keep in their heads, any procedure or policy that isn't reduced to writing is going to be difficult to articulate if it comes into question. In addition, if the investment policy is not reduced to writing, it may be difficult to demonstrate that the fiduciaries have properly decided on the required investment policies. Also, if the committee's conduct is ever challenged, it will be important to demonstrate that all of the committee members had a consistent understanding of what the investment policies were. Finally, it is difficult to document compliance with a policy that hasn't been documented itself. Bottom line, an IPS is evidence of having a prudent process to make required investment decisions. It also helps fiduciaries implement those decisions on a consistent basis. Fiduciaries should also consider having a plan policy statement that addresses three key issues – level of participation, deferral rates and quality of participant investing.

EXAMPLES OF INVESTMENT FIDUCIARIES

The individuals responsible for selecting and monitoring the plan's investment options are fiduciaries, in this case "investment fiduciaries." In most cases, the board of directors of a plan sponsor appoints a committee of officers to oversee the plan investments. In those cases, the board of directors must prudently select and monitor those investment fiduciaries. However, in some cases, no one is assigned the duty to select and monitor the plan investments; in those cases, the company retains the duty for selecting and monitoring the plan investments and the officers who make the decisions become "functional" investment fiduciaries.

At least one federal court has concluded that, based on the facts of that case, the failure of the plan fiduciaries to have an IPS was a breach of ERISA's general fiduciary rules.[46] However, there is no explicit requirement in ERISA that an IPS be prepared. But it is, at least, a best practice to prepare an IPS.

[46] *Liss v. Smith*, 991 F. Supp. 278 (S.D.N.Y. 1998).

Investment Policy Decisions

Prior to drafting an IPS, you should develop a process and the criteria that will be effective for both selecting and monitoring investments. The IPS will serve as your roadmap for those decisions.

The first consideration in this process should be the overall objective of the IPS. That is, what is the primary objective of the plan and how will the plan accomplish this objective. In general, the primary objective for adopting a retirement plan is to provide participants with a vehicle for accumulating retirement benefits.

Critical to achieving this objective is understanding the needs of plan participants. In order to understand the needs of participants, you should consider the make-up of your workforce. The ages, compensation and level of investment sophistication of your employees will impact the investment options you select.

Your second consideration is creating a process for selecting investments. ERISA requires that the plan fiduciaries make the necessary investment policy decisions.[47] Those decisions, in combination, are the plan's investment policy.

When the decisions are formalized in writing, they become the IPS. Those decisions include:

- the categories of investments to be offered (referred to as “asset classes”); and
- the criteria for the selection of the investment options that will populate those investment categories.

Your final consideration is developing a process for monitoring the investments. The criteria used for monitoring investments will often mirror the criteria used in selecting investments with one exception—the monitoring process must include a procedure for dealing with investments that are not meeting standards. For example, many IPS's include a procedure for placing investments on a “watch list.” An investment on the watch list is subject to a heightened level of review because, for example, of questionable performance and generally will be removed from the plan if it continues to perform poorly.

[47] DOL Interpretive Bulletin 94-2.

SELECTING INVESTMENTS BASED ON YOUR WORKFORCE:

Unsophisticated Workforce: If a company has a significant number of employees who are not knowledgeable about investing, the plan sponsor should consider using a limited number of investment options—all of which are core options. By "core" options, we mean an investment line-up of the most stable and diversified mutual funds, as opposed to highly volatile funds or funds that are limited to a single sector of the economy. In addition, the plan sponsor should consider investment options such as risk-based lifestyle funds, age-based lifecycle funds, managed accounts and/or asset allocation models that can be used by participants. In that way, the plan sponsor and fiduciaries will have provided the participants with the investments and services they need to develop prudent portfolios for retirement investing in their accounts.

Sophisticated Workforce: On the other hand, for a company that has a large number of employees who are highly educated, well-paid and knowledgeable about investing, the plan sponsor may offer a line-up of a large number of mutual funds of all categories, including those that are more volatile or more specialized. For example, that might lead to having a line-up of 20, 30 or 40 funds. In addition, the plan sponsor might consider offering a mutual fund window or a brokerage account for highly sophisticated employees who want to use their accounts with investments beyond those offered even in a robust line-up of mutual funds.

Combination Workforce: If the company has a wide range of employees, with a significant number in both the sophisticated and unsophisticated categories, the plan sponsor could offer a combination of the two by offering a limited line-up and a focus on investment solutions (such as lifestyle funds, lifecycle funds and asset allocation models) for the less sophisticated group, but then having a mutual fund window or a brokerage window for the most sophisticated employees.

Using Investment Policy Statements When Investing Plan Money

Finally, the IPS should be detailed enough so that if a reasonably knowledgeable person looks at the policy, he or she would be able to understand how decisions regarding investments are to be made. That means that the IPS should include clear standards for the selection of investments; the criteria for evaluating the performance of investments; the process used by the committee or other fiduciaries, including the general timing and frequency of meetings and procedures for dealing with investments that are not satisfying the articulated standards.

SELECTING INVESTMENTS

Examples of criteria which may be used in the selection of investments are:

- the performance of the investments over 1-, 3-, 5- and 10-year periods as compared to the appropriate index and/or to the peer group;
- the expense ratio of a mutual fund, as compared to the average expense ratio of the funds in its peer group; and
- the tenure of the manager and the stability of the staff at the investment management firm.

Implementation of an IPS

It is the investment fiduciary's responsibility to implement the IPS. In many cases, the plan sponsor will appoint an investment committee for that purpose. For small plans, committees usually meet at least annually and, for larger plans, they typically meet quarterly.

Selection of Investments and Related Services

The IPS should also cover the process for deciding about the investment structure of the plan; that is, the decisions about whether to offer brokerage accounts, company stock, and so on. In addition, the IPS should include the process for the selection of services such as participant education and advice services.

Further, the IPS should cover the selection of the default investment for the plan. The default investment is the investment for participants who "default," that is, who fail to designate how their accounts should be invested. Generally, fiduciaries will designate an investment option for the accounts of participants who did not make their own investing decision. The default investment should consider the need to invest in a manner to prudently accumulate retirement benefits and should include a mixture of various different types of stock, or "equity," investments; fixed income vehicles; and cash equivalents. The requirement that the default investment enable the participants to properly balance risk and reward is found in ERISA's reliance on the investment principles in Modern Portfolio Theory (MPT). The Pension Protection Act of 2006 added a new section (Section 404(c)(5)) to ERISA that provides a "safe harbor" for fiduciaries who invest participants in specified types of investments. The investments that meet this requirement include the following three investments: age-based, lifecycle or target date funds; a balanced fund, including risk-based lifestyle funds; or a managed account. For a more complete discussion, see "Qualified Default Investment Alternative" within the "Understanding My Liability" section.

Monitoring

An IPS also provides the criteria for monitoring the investment options and the procedures for, and consequences of, the application of those criteria to the investment options. Typically, the IPS will describe the benchmarks to be used for monitoring each investment option, who will be responsible for conducting the review and how often the monitoring will take place. In other words, as an investment fiduciary, you have a duty to determine whether the investments are suitable and appropriate initially, and also whether they continue to be.

In addition to your ongoing duty to monitor the investments in the plan, you also have an ongoing duty to review the IPS. It is a good practice to review the IPS annually and, if needed, to make any necessary changes.

CASE STUDY

Monitoring Investments

The Acme Company plan includes a fund that is underperforming. The plan committee meets but does not discuss that fund.

What should the committee have done? The committee has to address the issues that are presented—in this case, a fund that is not meeting the criteria in the plan. The committee should consider putting that fund on the watch list while the committee gathers more information or simply waits for a short period of additional time to determine whether it is just a temporary phenomenon or a larger problem. If the fund is placed on the watch list, the committee will, in due course, need to make a decision. They can ultimately decide to take it off the watch list and leave it in the line-up or to remove it, but it is a mistake to have a fund perpetually on the watch list.

PRACTICAL TIPS

Developing, Implementing and Monitoring an IPS: In developing the IPS and in implementing it, the committee always needs to keep in mind the fundamental fiduciary principle that they have to act for the exclusive purpose of providing retirement benefits. In other words, their objective is to provide investments and services that a prudent person would include to support the accumulation of retirement benefits. That may mean that, depending on the make up of the work force, some investments are simply inconsistent with the objective of retirement benefits, such as highly volatile or overly narrow-focused or non-diversified investment options. Those considerations are factors both in the development of the IPS and in the implementation of the IPS.

Reviewing the IPS: A failure to follow the terms of the IPS is a fiduciary breach. Therefore, the plan committee is obligated to follow the IPS or to modify it if the committee no longer believes that its provisions are appropriate. So, the committee should, as a matter of good practice, review the IPS at its first meeting each year. A review would include big picture issues, such as whether the overall investment structure and the categories of investments are appropriate, as well as more detailed issues, such as the specific criteria that are being used.

IPS Criteria Should Serve as a Guideline and not a Mandate: The IPS should be drafted so that the investment fiduciaries, such as the committee members, will exercise their best discretion and judgment. In that vein, the IPS should also say that the provisions of the IPS are not binding on the fiduciaries, but instead are included in the IPS as guidelines to assist the fiduciaries in the exercise of their judgment and discretion. This language minimizes the possibility of a fiduciary breach because of the failure to follow a minor provision in the IPS.

Each committee member, including members that join the committee after the IPS has been prepared, should carefully review the IPS and make sure that they understand it and feel that they can implement it.

Concept of a Plan Policy Statement

The main objective of a retirement plan is to provide a vehicle for participants to accumulate retirement savings. The IPS addresses the selection and monitoring of appropriate investments and investment-related services, while a plan policy statement addresses the operation of a successful retirement plan. A successful retirement plan is one which both satisfies ERISA's fiduciary rules and provides participants with retirement benefits that are adequate to provide a decent living in retirement. The benefit of a plan policy, as with an investment policy statement, is that it helps the plan sponsor and fiduciaries focus on the key issues for a successful retirement plan and the development of processes to address those issues. The policy also helps the plan sponsor and fiduciaries implement their decisions in a consistent and thoughtful manner. While it is helpful to have a plan policy statement, it is not required by law.

A successful retirement plan takes more than selecting appropriate investments. Consider a 401(k) plan with an investment menu that contains appropriate investments that are performing well, but only 40% of the employees eligible to participate are deferring. In successful retirement plans, in addition to providing prudent investments, plan sponsors and fiduciaries also consider the following factors:

1. The percentage of eligible employees who are deferring into the plan;
2. The percentage of pay the employees are deferring; and
3. The quality of participant investing.

If, after considering the above factors, the plan sponsor and fiduciaries determine that the results are unlikely to meet the objective of a successful retirement plan, they should take action.

In some cases, that action may be required by law, such as the requirement that the plan's operation and services be prudently implemented—and successful results are evidence of prudent implementation. In other cases, the action may be motivated by the desire of the plan sponsor to benefit its employees, and not by the law. For example, it is the plan sponsor who makes the decision whether or not to use automatic enrollment.

In cases where the percentage of eligible employees participating in the plan is low, the fiduciaries should consider whether they have taken the appropriate steps to communicate with and educate eligible employees on the importance of participating in the plan. In cases where the participating employees are not adequately deferring, the fiduciaries should consider whether they have taken prudent steps to assist participants in understanding and contributing at the level needed to obtain adequate retirement benefits. Finally, in cases where participants are not adequately diversified, the fiduciaries should consider whether they are providing participants adequate education about investing for the purpose of accumulating adequate income benefits. With respect to a plan that includes employer securities as an investment option, participants must be given a notice regarding their diversification rights and the importance of diversification.[48]

[48] ERISA §101(m).

How CUNA Mutual Group Can Help

At least one federal court has concluded that, based on the facts of the case, the failure of the plan fiduciaries to have an Investment Policy Statement (IPS) was a breach of ERISA's general fiduciary rules. However, there is no explicit requirement in ERISA that an IPS be prepared. But it is, at least, a best practice to prepare an IPS.

Even though a written IPS is not specifically required by the law, there are legal requirements that fiduciaries make investment policy decisions. An IPS helps fiduciaries do a better job of fulfilling their legal responsibilities on a timely and consistent basis.

CUNA Mutual Group supports its clients by providing model IPS language. While fiduciaries must still give careful thought to developing a process that will work for them in selecting and monitoring plan investments, the model IPS serves as both a starting point and as a checklist of the items to be covered. Contact your Plan Consultant to receive a current sample that corresponds to your plan type.

Understanding and Limiting My Fiduciary Liability

Additional Information

Limiting the Liability

Co-Fiduciary Liability

Bond and Fiduciary Liability Insurance

ERISA Section 404(c) Relief

Automatic Enrollment

Qualified Default Investment Alternative (QDIA)

Blackouts and Mapping

How CUNA Mutual Group Can Help

Understanding My Liability

There is risk involved in acting as a fiduciary. When performing their duties, ERISA fiduciaries are held to high standards. As one court has said- and many have repeated: "The fiduciary obligations of the trustees to the participants and beneficiaries of the plan are…the highest known to the law."[49]

What happens when a fiduciary fails to perform his duties or fails to meet the standards set by ERISA and the IRS? If the fiduciary breaches his duties, he is liable for any losses resulting from that breach.

In order to protect against liability, fiduciaries need to create and implement a process for making prudent decisions, follow that process, and document that process.

ERISA imposes personal liability on fiduciaries that, by their breach of fiduciary duty, cause the plan to suffer losses.[50] In determining whether a fiduciary is liable, courts will generally look to the fiduciary's conduct, rather than focusing on the loss, to determine whether such conduct met the fiduciary standards. In other words, if a fiduciary engaged in a prudent process in making a decision and properly implemented and monitored the decision, the fiduciary will not be liable for losses that later occur.

[49] *Donovan v. Bierwirth*, 680 F.2d 263, 272 (2d Cir. 1982).
[50] ERISA §409.

In instances where the conduct did not meet the law's standards and the fiduciary breached his duty, the damages are measured under a "but for" test. What that means is that the measure of the damages is the amount that would restore the plan to the position it would have been in "but for" the breach.[51]

In addition to the liability for fiduciary breach, fiduciaries may also be assessed civil penalties under ERISA. In particular, ERISA §502(l) allows the DOL to impose a civil penalty against a fiduciary who breaches its fiduciary responsibility or who commits another violation of ERISA, such as a prohibited transaction (for a complete discussion of prohibited transactions see Avoiding Prohibited Transactions). The penalty is 20% of the amount recovered. In addition, under ERISA §502(l) the DOL may impose a 10% penalty as a result of a prohibited transaction if the plan involved in the prohibited transaction is not a qualified plan. Further, prohibited transactions are subject to the excise tax provisions of section 4975 of the Code. However, the section 502(l) penalty is offset by any excise tax imposed under section 4975. But, the interest accrued on an excise tax assessment is not allowable as an offset to the section 502(l) penalty.

[51] *Donovan v. Bierwirth*, 754 F.2d 1049, 1056 (2d Cir. 1985).

CASE STUDIES

Fiduciary Liability

Situation: Acme Company failed to timely deposit employee deferrals to the plan.

What are the consequences? Acme Company has engaged in a prohibited transaction.

What should Acme Company do? Correct the prohibited transaction. Acme Company must restore the deferral amounts to the plan's trust (including lost earnings on such amounts) and file a Form 5330 with the IRS to pay the excise taxes (which is a 15% excise tax on the lost earnings during the period when the deposit wasn't made timely.) The company should also consider filing under the Department of Labor's Voluntary Fiduciary Correction Program to obtain a no action letter with respect to the issue.

Situation: The members of Acme Company's plan committee are responsible for monitoring the plan's investments. The committee failed to monitor all the investments offered under the plan and as a result a poorly performing mutual fund remained in the plan when it should have been removed.

What is the measure of damages? Although it is not entirely clear, the most likely measure would be the difference between the performance of the index for that type of fund and the performance of the mutual fund in the Acme Company Plan. For example, if the mutual fund in the Acme Company Plan was level (*i.e.*, it did not make any money for the past three years) but the index was up 10% per year, then the fiduciaries would have to restore to the plan the amount of earnings for each of the three years.

Limiting the Liability

Although fiduciaries cannot eliminate the potential for plan investment losses, they can reduce their risk of being liable for those losses. In order to protect against liability, fiduciaries need to create and implement a process for making prudent decisions, follow that process and document that process.

Engaging in a Prudent Process

As discussed in "The Prudent Man Rule" under the "My Fiduciary Responsibilities" section, fiduciary conduct is measured by the prudent man rule. Note that the prudent man rule is described in terms of how a fiduciary must act, and not by the results a fiduciary must obtain. This is significant because it highlights that the result of a decision is not generally as important—at least from the legal perspective—as the process by which the fiduciaries arrived at the result. However, the result is by no means irrelevant. For example, if fiduciaries make an imprudent decision about an investment, but the investment performs better than its benchmarks, then the fiduciaries will have committed a breach, but there will not be any losses or damages.

Fulfillment of the fiduciary duty of prudence is measured by the process used by the fiduciaries. This process consists of the duty to investigate, the duty to evaluate that information, the duty to obtain expert advice when needed, the duty to make and implement decisions, and the duty to maintain records. The decision based on those steps must be informed and reasoned. That is, the fiduciaries must make their decision based on that information and the decision must have a rational connection to the information. If ERISA fiduciaries meet these requirements, they should feel comfortable that they have acted prudently under ERISA's fiduciary standards.

The prudence requirement applies to every fiduciary decision: the selection of investments; the selection of service providers, such as investment advisers, third-party administrators, and providers of participant education; and the decision to continue offering investments or using service providers (the phase known as "monitoring").

Maintaining Due Diligence Files

As mentioned under "The Prudent Man Rule" in "My Fiduciary Responsibilities" section, a prudent process focuses on the work the fiduciary did in making the decision, rather than on the results. However, the focus on process, as opposed to results, provides little relief to a fiduciary facing a suit for breach if he failed to document his process. When a fiduciary fails to document the decision-making process, it will be difficult to demonstrate that there was a prudent process.

As a fiduciary, you should understand the importance of documentation. You should always document issues considered and decisions made and the basis for those decisions. Inherent in your fiduciary duty to investigate is the need to document your process and be able to demonstrate that you actually took the steps required by a prudent process. For example, in its brochure "Meeting Your Fiduciary Responsibilities," published in October 2008, the DOL wrote: "Prudence focuses on the process for making fiduciary decisions. Therefore, it is wise to document decisions and the basis for those decisions."[52] So, as a fiduciary, you should maintain records of meetings as well as due diligence files for all decisions, including the selection of each provider and adviser. The due diligence file should include all the information reviewed and advice received. For example, when selecting a provider, the file should include information about the provider's services and costs, as well as a copy of the contract with the provider.

[52] http://www.dol.gov/ebsa/publications/fiduciaryresponsibility.html.

Co-Fiduciary Liability

ERISA provides that a fiduciary can be liable for a breach of another fiduciary.[53] There are three ways a fiduciary can be liable for the breach of another fiduciary:

- the fiduciary participates knowingly in, or knowingly conceals an act or omission of a co-fiduciary which he knows constitutes a breach;
- the fiduciary failed to comply with ERISA's fiduciary standards (prudence or loyalty requirements or failure to follow plan documents), in the performance of the fiduciary's specific responsibilities which enabled another fiduciary to commit a breach;
- the fiduciary has knowledge of a breach of the other fiduciary and does not make reasonable efforts under the circumstances to remedy the breach.

CO-FIDUCIARY LIABILITY

Acme Company is late in making its deposits of employee deferrals into its 401(k) plan. A fiduciary—who is not directly responsible for either forwarding the deferrals or for collecting them—becomes aware of the failure to deposit deferrals. The fiduciary does nothing to remedy the situation.

Can that fiduciary be liable if there are losses of employee money due to the failure to transfer the deferrals?

Yes. ERISA Section 405 provides for co-fiduciary liability and, in particular, Section 405(a)(3) provides that a fiduciary shall be liable for a breach of fiduciary responsibility of another fiduciary if he or she has knowledge of a breach by such other fiduciary unless he or she makes reasonable efforts under the circumstances to remedy the breach.

The method for calculating a co-fiduciary liability is the measure of any losses that the fiduciary could have saved by taking prudent steps to protect the participants. So, the fiduciary would not necessarily be liable for all the losses or even any portion of them. However, if the fiduciary could have prevented the losses and did not, then the fiduciary will be liable for those losses.

What should the fiduciary have done?

The fiduciary should have worked with Acme Company to get the deferrals deposited as quickly as possible along with any interest.

[53] ERISA § 405(a).

Fiduciary Liability Insurance and ERISA Fidelity Bond

Fiduciary Liability Insurance

Another way to protect the plan and the participants is for the employer to obtain fiduciary liability insurance. The committee members are ultimately responsible for making sure the plan runs properly and its investments are prudently chosen. But in the complicated world of participant-directed plans, mistakes can happen.

NOTE TO FEDERAL CREDIT UNIONS: Federal credit unions acting as fiduciaries are required under the National Credit Union Administration rules to have fiduciary liability insurance.[54] To protect the participants and the plan committee members, and to meet NCUA regulations, a fiduciary liability insurance policy should be obtained. Fiduciary liability insurance pays for losses caused by a breach of fiduciary responsibility.

ERISA Fidelity Bond

While fiduciary liability insurance protects against fiduciary breaches, an ERISA fidelity bond covers acts of dishonesty against a pension plan, such as embezzlement or theft. ERISA requires pension plans to obtain a fidelity bond to protect the plan against theft of plan funds by fiduciaries and other "plan officials."[55] This means that anyone with discretionary or actual authority or control over the plan, especially the plan funds, must be covered under the Bond. This would include not only the plan trustee, but also the company's board of directors, employees and third parties who handle plan funds or employee deferrals. The committee should make sure the plan has a compliant fidelity bond – covering the people who handle plan assets.

[54] NCUA Reg. § 701.19(e).
[55] ERISA § 412(a)

Understanding and Limiting My Fiduciary Liability

QUESTIONS TO ASK BEFORE PURCHASING FIDUCIARY LIABILITY INSURANCE

Insurance coverage can vary from carrier to carrier, so it is important for plan sponsors and fiduciaries to make sure that the plan has adequate coverage. Below are a series of questions to assist plan sponsors and fiduciaries in obtaining information. CUNA Mutual Group's answers to those questions appear below. Please note that this list is not intended to be exhaustive as there may be follow-up questions.

1. **Who is covered?** CUNA Mutual Group's Fiduciary Liability Policy protects the plan sponsor, the employees, directors, volunteers and fiduciaries of the company plan.
2. **Does the policy cover more than one plan?** Yes – multiple plans can be covered as long as the company provides a Form 5500 for each plan it desires to be insured.
3. **How long does the policy run (*i.e.*, what is the period of coverage)?** Fiduciary Liability Insurance is provided on a claims-made basis, meaning that the policy which is in force at the time the claim is made will be the policy that responds to the claim. The typical policy term for coverage is one year.
4. **What is the policy limit? Is there a per claim limit and an aggregate limit?** CUNA Mutual Group provides several policy limit options. Annual aggregate limits of liability are available for $100,000, $250,000, $500,000, $1 million, $2 million, $3 million, $4 million or $5 million. Refer to the CUNA Mutual Group Insurance Product Sheet for information on policy limits including per claim and aggregate limit information.
5. **Is there a deductible?** Yes, a minimum deductible of $1,000 is available, with options of $2,000, $2,500 or $5,000.
6. **Does the policy cover negligent acts in plan administration?** Yes. Negligent acts, errors or omissions in interpreting, counseling employees or handling of records of employee benefit plans are covered.
7. **Are there any acts excluded?** Yes. The Fiduciary Liability Insurance Policy, like all insurer liability policies, contains exclusions.
8. **Does the policy cover fines and penalties?** No. Fiduciary Liability Insurance covers defense costs and compensatory damages as a covered loss. Non-compensatory damages and fines and penalties are not covered.

The fidelity bond must meet the following requirements:

- The amount of coverage must equal at least 10% of the plan funds (determined at the beginning of the plan's fiscal year), but must be at least $1,000 and is not required to be more than $500,000 ($1,000,000 for plans that include employer securities).
- If more than one plan is covered under the bond, the bond must allow recovery for each plan in the amount that would be required if the plan were covered under a separate bond.
- The bond must protect the plan against a loss of plan money due to "acts of fraud or dishonesty on the part of the plan official, directly or in connivance with others."
- The bond must provide coverage from the first dollar of loss. No deductible is permitted.

The failure to have a fidelity bond is a fiduciary breach and, as a result, the fiduciaries could be indirectly liable for any losses resulting from embezzlement of employee deferrals or other plan assets because of the failure to have a fidelity bond. Fiduciary liability insurance does not cover a fiduciary's breach of failing to maintain the required bond coverage so it is critically important that the required bond coverage be obtained.

PRACTICAL TIP

Depending on how a fidelity bond is worded, the fiduciaries may need to keep it up to date. For example, some fidelity bonds require that all of the bonded people be individually listed. Of course, as employees come and go, the bond gets out of date very quickly. While other fidelity bonds only cover employees, which would exclude directors, independent contractors, and others who are not common law employees. Of course, that's inadequate under the law.

Every year, at the annual meeting of the committee or some other time, the fiduciaries should review the fidelity bond to make sure that it satisfies the legal requirements and that it has not gotten out of date because of, *e.g.*, employee turnover.

ERISA Section 404(c) Relief

While a plan is not a guarantor of investment return, the fiduciaries of a plan are ultimately responsible for the prudent selection of the investment options and may be liable for breaches of that duty. However, if a plan permits participants to direct their investments (as most 401(k) plans do), and if the plan complies with the requirements of Section 404(c) of ERISA (and the regulation under that section), the fiduciaries of the plan are not liable for investment decisions made by participants. That is, the responsibility for using those investments—sometimes called "asset allocation"—is transferred to the participants. Fiduciaries only have limited comfort from that relief because they still are legally responsible for making sure that the investments are prudently selected and monitored.

Under Section 404(c), if participants have a right to control the investments in their accounts and can select from a "broad range" of investment options, the fiduciaries will not be liable for losses suffered by participants resulting from their control over their accounts. As part of its participant fee disclosure regulations,[56] the Department of Labor revised the 404(c) regulation to integrate the new disclosure requirements, that is the 404a-5 disclosures are now required for 404(c) protection, but many of these requirements were already in the 404(c) regulation. Since much of the information must be provided in any case, fiduciaries may be even more likely to take advantage of 404(c) protection. Still, in order to obtain the 404(c) relief, there are several conditions in the 404(c) regulation that a plan sponsor must satisfy,[57] in addition to the required participant disclosures.

Some of those requirements are:

- The participant must have an opportunity to obtain written confirmation of his instructions;
- The 404(c) fiduciary must provide the following to the participants:
  1. An explanation that the plan is intended to be a 404(c) plan;
  2. An explanation that the fiduciaries of the plan may be relieved of liability for losses for participant decisions;
  3. An explanation about giving investment instructions and any limitations on giving instructions;

[56] 29 C.F.R. § 2550.404a-5.
[57] 29 C.F.R. § 2550.404c-1(b).

- The participant has the opportunity to materially affect the potential return and risk on his or her account by selecting among a broad range of diversified investment options—the “broad range” requirement;
- The plan also offers an income-producing, low risk, liquid investment option.

NOTE: There are additional requirements for 404(c) protection if company stock is offered as an investment option.

PRACTICAL TIP

The committee should designate one individual (or consider creating a subcommittee) as being responsible for ensuring that the plan meets the 404(c) requirements. That individual or subcommittee will be responsible for setting up the processes and working with the plan’s adviser and provider to ensure that the plan is 404(c) compliant and would be identified as the 404(c) fiduciary in the summary plan description.

Automatic Enrollment

Plan sponsors may assist their employees in their retirement savings efforts by automatically enrolling them in the plan. In a plan with automatic enrollment (also referred to as “negative election”), employees eligible to participate in the 401(k) plan are automatically enrolled in the plan and, unless they affirmatively opt out of the plan, have a portion of their pay deferred into the plan. By including an automatic enrollment feature in the plan, the company can increase participation rates and provide benefits to more eligible employees.

There are several different ways in which a plan sponsor can implement an automatic contribution arrangement. For example, if the plan sponsor adopts an eligible automatic contribution arrangement (EACA) employees who are automatically enrolled may withdraw the initial contributions during the first 90 days of enrollment. On the other hand, a plan that has a qualified automatic contribution arrangement (QACA), will be deemed to satisfy the actual deferral percentage (ADP) and actual contribution percentage (ACP) tests discussed later in the “Compliance Guidelines” section. Since participants who are automatically enrolled generally do not make investment elections, fiduciaries of such plans usually decide to have their contributions invested in a qualified default investment alternative (QDIA) as described on the next page.

Qualified Default Investment Alternative (QDIA)

For participant-directed plans, fiduciaries are required to exercise independent discretion and judgment in investing the money of those participants who do not direct their own investments. In fulfilling that responsibility, fiduciaries must act for the exclusive purpose of providing retirement benefits, that is, they must select investments that balance risk and reward.

Many investment experts believe this requires an allocation to both equities and fixed income, consistent with the principles of modern portfolio theory. If the fiduciaries select a particular investment for that purpose—as they often do, it is called the "default investment" or "default account." The Pension Protection Act of 2006 extended 404(c) relief to fiduciaries who invest participant assets in specified default investments.[58] In effect, the fiduciaries are given the equivalent of a "safe harbor" if they follow these rules.

Section 404(c)(5) of ERISA provides that, in situations where participants have an opportunity to direct their investments but fail to do so (*i.e.*, a "default"), those participants will be treated as having exercised control over their accounts if they are invested in a qualified default investment alternative ("QDIA"). The protections afforded by 404(c)(5) are available to all default investments that qualify as QDIAs. The DOL guidance provides that a QDIA must be one of three types of investments (an age-based fund, also called lifecycle or target date funds; a balanced fund, including risk-based lifestyle funds; or a managed account).

The protections afforded by using a QDIA are especially important to plans with automatic enrollment—because a substantial portion of the participants in those plans do not direct the investment of their accounts and, as a result, the fiduciaries make the investment decision. So, by providing a default investment that meets the QDIA requirements and by automatically placing participants in that investment, the fiduciaries are protected for those investments (but the fiduciaries must prudently select and monitor the QDIA).

[58] Pension Protection Act of 2006 § 624

Blackouts and Mapping

The DOL defines a blackout period as any period of more than three consecutive business days during which the ability of participants and beneficiaries to direct or diversify investments or to obtain loans or distributions is suspended, limited or restricted. Blackouts often occur when a plan is removing and replacing investments, though they may also happen when a plan changes recordkeepers. Basically, during a blackout, participants' ability to make investment changes is taken away until the money has been transferred to the new investment or the new recordkeeper.

The change of investment providers and the implementation of a blackout are both fiduciary actions. As a result, they must be handled in a prudent manner. One of your duties will be to notify participants in advance (generally at least 30 days) of the blackout.[59] Another duty will be to make sure that the participants are educated on the new investment options so that they can properly decide among them. Also, you must decide whether to have the participants elect, before the blackout, which new funds their accounts will be transferred into or, alternatively, to "map" their investments into funds offered by the new provider. "Mapping" is a process where the money is transferred to the most similar funds offered by the new provider. The Pension Protection Act of 2006 provides 404(c) fiduciary protection for the mapping of participant investments if the plan satisfied the conditions of the 404(c) regulation prior to the change and the participants' investments are moved to an investment option that is reasonably similar "in risk and rate of return" to the characteristics of the investment option offered immediately before the change. In addition to meeting those conditions, the plan sponsor must provide the participants written notice of the change at least 30, but not more than 60 days, before the effective date of the change.

[59] ERISA §101(i).

MAPPING

Acme Company's plan committee decides that it would like to replace the Large Cap Growth Fund with another fund. The committee determines that the replacement fund is reasonably similar to the removed fund.

In order to receive 404(c) protection for its mapping:

- Participant investments must be moved to an investment option that is reasonably similar "in risk and rate of return" to the characteristics of the investment option offered immediately before the change;
- Participants must receive written notice of the change at least 30, but not more than 60 days, before the effective date of the change;
- The notice must include a comparison between the old and new investment options and must explain that, absent affirmative investment instructions from a participant to the contrary, the participant's account will be invested in the new investment option, which has characteristics reasonably similar to the characteristics of the old investment option; and
- Finally, the plan must have satisfied the conditions of the 404(c) regulation prior to the change.

How CUNA Mutual Group Can Help

While fiduciary breaches can be limited by thoroughly understanding your responsibilities, there are additional safeguards you can put into place with CUNA Mutual Group's help.

Plan Features and Options

Automatic Enrollment CUNA Mutual Group offers an automatic 401(k) feature with two options:

Automatic Enrollment Program:	Automatic Enrollment PLUS Auto Savings Increase Program:
The plan sponsor chooses the default investment account allocation and contribution percentage.	The plan sponsor chooses the default investment account allocation and contribution percentage. The plan sponsor also sets an annual contribution percentage increase and a maximum percentage target.
When selecting the default investment option, plan sponsors can choose one or any combination of the investment account options offered in the plan.	When selecting the default investment option, plan sponsors can choose one or any combination of the investment account options offered in the plan.
Employees will receive a notice to enroll online prior to their entry date. If the employee does not enroll or opt out by the last enrollment date or within 30 days of the date of notice, he will be automatically enrolled.	Employees will receive a notice to enroll prior to their entry date. If the employee does not enroll or opt out by the last enrollment date or within 30 days of the date of notice, they will be automatically enrolled. The notice received also defines the auto savings increase.
Employees who have been automatically enrolled will have the option to review/change the enrollment elections online.	Employees who have automatically enrolled with auto savings increases will also be able to view/change the increase percentage and date of annual increase online.

CUNA MUTUAL GROUP

Qualified Default Investment Alternative (QDIA).
All CUNA Mutual Group retirement plans offer Target Retirement Date fund options for you to offer in your plan to your employees. Target Retirement Date funds are an appropriate investment option to serve as a QDIA. For more information regarding the Target Date fund options in your plan, visit the *Investment Options and Reports* page under the *I Want To* tab.

Products and Services

ERISA/Pension Bond. ERISA requires that the fiduciary and people who handle plan assets be bonded for dishonest acts against the plan. This is typically referred to as a "fidelity bond."

Fiduciary liability insurance is an insurance policy obtained by the employer to protect the plan and the participants against losses caused by a breach of fiduciary duty.

NOTE TO FEDERAL CREDIT UNIONS: The National Credit Union Administration (NCUA) rules require that fiduciaries of federal credit unions have Fiduciary Liability Insurance coverage to pay for losses caused by a breach of fiduciary liability in order to protect the participants of the plan and the plan committee members.

CUNA Mutual Group offers both Bond Coverage as well as a Special Insurance Package (that contains Fiduciary Liability coverage). Contact your Sales Executive for information on these coverages for credit unions.

Additional Information

Compliance Guidelines

Plan administration includes both the Code requirements, like plan testing, and ERISA rules like reporting and disclosure, bonding requirements, and fiduciary liability insurance. The following pages touch on some of the more important issues for the administration and oversight of participant-directed retirement plans. It is by no means exhaustive, either in the topics covered or in the discussion of each topic. Rather, it is intended to serve as an overview to introduce you to the types of compliance issues involved in managing retirement plans.

Plan Qualification

If a plan is tax-qualified, the employer is able to deduct its contributions to the plan for tax purposes (not applicable for tax-exempt organizations), the employees are not taxed on the matching (or other employer) contributions, and the earnings of the trust fund of the plan are “tax deferred” until the money is paid to the participants. If the plan doesn’t follow the Code’s qualification requirements, it may be disqualified by the IRS, which means that the employer, the employees and the trust fund lose the favorable tax treatment.

A key qualification requirement is that the plan document must be consistent with the Code’s requirements. This is known as “complying as to form.” If requested, the IRS will review plan documents and will issue a “favorable determination letter” or “FDL” confirming that the plan is qualified, at least the language in the document. Although a FDL is not required by law, the possession of an FDL provides the plan sponsor assurance that the plan document cannot be challenged in an IRS audit as to its form, *i.e.*, the IRS has approved the wording of the document. Similarly, a plan document may be pre-approved by the IRS so that a provider can offer a low-cost qualified solution to its clients.

However, the possession of an IRS approval letter will not protect or immunize a retirement plan from disqualification if the plan is operated in a discriminatory or non-compliant manner. That is, the plan must still be operated according to its terms (which is sometimes referred to as “operational compliance”).

From time to time, Congress passes new rules for qualified retirement plans, and companies are required to amend their plan documents to make sure their language continues to comply with the law. Each law has a deadline for those amendments, and if the plan is not properly amended before that deadline, it can lose its tax preferred, or qualified, status. Most employers adopt a pre-approved plan (*i.e.*, master and prototype (M&P) plans and volume submitter (VS) plans) of a provider).

One of the plan sponsor’s jobs is to make sure that the plan document is kept up to date with the legal requirements. A second—and equally important—job for both the plan sponsor and the committee is to make sure that the plan is operated according to its provisions.

PRACTICAL TIP

The IRS has set up programs so that companies can correct most violations of the retirement plan qualification rules, whether discovered by the IRS or the company. However, if the IRS discovers a significant violation, a penalty will be assessed against the company as a part of the correction.

Situation:
Acme Company fails to allow an eligible employee to participate in its plan. The employee satisfied the age and service requirement, but Acme Company failed to notify the employee that she was eligible to participate in the plan and failed to give her the enrollment materials, including deferrals forms.

Result: The employee has missed the chance to make a deferral, the dollars that would have been contributed are still in the possession of the employee. The affected employee has lost the opportunity to put a certain amount of money into a tax-favored account. The improper exclusion of an eligible employee from making elective deferrals will cause a plan to become disqualified, resulting in adverse tax consequences to the employer and employees under the plan. However, the IRS has programs that allow companies to obtain relief by correcting its failure.

Correction: The IRS offers two programs under its correction programs, which the plan sponsor may use to correct this problem: the Voluntary Correction Program (VCP) and the Self-Correction Program (SCP). The correction method is based on the "lost opportunity cost" for the employee to make deferrals. The required make-up payment is 50 percent of the pre-tax deferrals the employee would have made had the employee been timely included in the plan. This is based on the employee's compensation times the average deferral percentage of the employee's class. The employee's class is determined by his compensation. If he is highly compensated he will be part of that class but if he is not a highly compensated employee he will be grouped in the class with other non-highly compensated employees. (NHCE or HCE).

In addition, a matching contribution must be made as if the employee had deferred 100% of the class percentage of pay. And, finally, any "lost earnings" must be contributed.

Nondiscrimination Testing

To be qualified, contributions to the plan cannot exceed the limits in the Code. This requirement is based on the principle that the tax benefits on a qualified plan cannot unduly benefit highly compensated employees. There are two major restrictions: percentage limits and contribution limits. If the plan fails either of these two tests, then the failures must be corrected or the plan can lose its favorable treatment under the tax laws. The committee is responsible for overseeing the administration of these tests and, if failures occur, for correcting the excesses.

Percentage Limits

Under the percentage requirements, the plan must pass two percentage tests. The first test compares the average rate of the deferrals of highly paid employees and the rate for the non-highly paid employees. This is called the “average deferral percentage” or “ADP” test. In order to pass the test, the average deferral percentage of the highly paid employees cannot exceed the ADP of the non-highly paid by more than certain amounts. The second percentage test compares the rate of matching contributions made by the employer for the benefit of the highly paid group and the non-highly paid group. This is the “average contribution percentage” or “ACP” test. Again, the rates of contribution are compared, and the percentage of contributions by the employer for the highly paid cannot exceed the percentage for the other employees by more than the limits in the Code.

Corrective action must be taken if the plan fails either test. The most common corrections are either (i) for the plan to give part of the money (the “excess” amount) back to the highly paid employees or (ii) for the employer to put more money into the plan for the non-highly paid employees.

The committee must make sure the tests are done every year, that the right information is used in doing the tests (*i.e.*, the right employees and the proper amounts of pay), and, if there is a violation of the rules, that corrective action is taken on a timely basis to fix that violation.

Contribution Limits

The tax laws also impose limits on the dollar amounts that can be contributed to a plan for each participant. The first is a limit on the amount a participant may defer each year. The maximum for 2015 is $18,000. (This amount is increased from time to time to take into account increases in cost of living.) The second is an overall limit on the total amount, counting deferrals, matching contributions, profit sharing contributions, and allocations of forfeitures that can be contributed for any one employee. For 2015, the limit is the lesser of $53,000 or 100% of compensation. Third, the maximum compensation that can be considered for deferrals is limited. For 2015, the limit is $265,000. Finally, in addition to the amounts above, participants who are 50 and older may make "catch-up contributions." For 2015, the catch-up contribution amount is $6,000.

The committee should make sure that procedures are in place to ensure compliance with these limits. This would include making sure that the employer's payroll software or payroll service will not permit deferrals in excess of the limit. It also means making sure that testing is performed annually, so that if excess contributions are made, the excess is promptly removed. Finally, it means correcting the violation in a way that is consistent with the law and with the terms of the plan document.

Compliance Issues

Timing of Deferral Deposits

For plans that allow participant contributions, money is withheld from the employees' paychecks and transferred to the trustee for investment. It is the responsibility of the plan sponsor and the committee to make sure the deferrals, as well as loan repayments are timely deposited. That means that the plan sponsor and committee need to make sure that the money is moved from the company's account into the plan's trust account as soon as possible. To accomplish this, the plan sponsor and committee should set up procedures at the company to make sure the deferrals are sent to the trustee on payday or within a few days after each payday. As discussed in "Examples of Fiduciary Violations," if the employer continues to hold onto the money after it reasonably could have transferred it to the trustee, then the employer has violated the fiduciary and prohibited transaction rules and the committee must take affirmative steps to protect the plan and the participants.

The DOL guidance requires that deferrals be put into the 401(k) trust as soon as the amounts can be "reasonably segregated" from the employer's general funds, but in no event later than the 15th business day of the month after the money was withheld from an employee's paycheck. However, the 15th business day limit is not a safe harbor. In fact, the regulations state—and it is the DOL's enforcement position—that the deferrals must be placed in the trust much sooner than the outside date. For small plans there is a 7-day safe harbor.

How do you know when the amounts can be reasonably segregated? For small plans (*i.e.*, fewer than 100 participants), employers have a safe harbor if the contributions are made no later than the 7th business day after withholding.[60] However, for large plans unfortunately, there is no bright line test. Sending the money later than a few days after payday would ordinarily not be acceptable to the DOL. The committee should make sure that proper procedures are in place to ensure timely deposit. If the committee learns that the deferrals are not to be deposited within a few days after the payroll, it should immediately investigate and take steps to protect the participants.

[60] DOL Reg. §2510-3-102(a)(2).

Why is this requirement imposed? First, a fiduciary is required to hold plan funds, such as the deferrals, in a trust where they cannot be used by the employer or seized by its creditors. Second, the deferrals, as plan money, must be made "productive"—that is, be invested—for the benefit of the participants. The reasoning behind the requirement is that employees are forgoing part of their pay to make contributions for their retirement, so they have a right to know that this money is protected and working for them. If this doesn't happen, the participants may look to both the company and the committee members to make good any losses, including lost earnings, that result.

What happens if the deferrals are not timely deposited? The committee may not be in charge of sending employee deferrals to the trust, but it does have oversight responsibility. As discussed in the "Examples of Fiduciary Violation" section, a committee member—as a co-fiduciary—can be personally responsible for any preventable losses if he learns that the deferrals have not been sent to the trustee, but does not take steps to correct the problem. Remember, as a fiduciary, you cannot disregard facts that could hurt the participants—you have a duty to act on their behalf. And, you can't avoid that responsibility by resigning; you have a duty to act. The first step is to insist that the money be sent to the trust. If that fails, you should get expert advice on the right steps to protect the participants.

Charges and Expenses of the Plan

Fiduciaries are entrusted with using plan funds to pay reasonable expenses for plan administration. This can include accounting and legal fees, trustee fees, recordkeeping, claims processing fees, investment management, and brokerage fees necessary for the operation of the plan.

Services that primarily benefit the employer should not be paid from plan money. So, the committee must review any charges to the plan before the expenses for these charges are paid for out of plan funds to determine whether the expense benefits the employer or the plan and its participants. For example, plan money should not be used to pay employer expenses, such as for the design, establishment, or termination of a plan. However, once a decision is made to adopt or terminate a plan, the implementation of that decision is a fiduciary act, and the implementation expenses can be paid by the plan. Penalties, excise taxes, and other sanctions that may be imposed by governmental bodies cannot be paid from plan assets.

Monitoring Loans and Hardship Withdrawals

Many plans allow participant loans or withdrawals in the case of financial hardship to encourage employees to defer more of their wages. Fiduciaries must adopt written guidelines for these programs and communicate these guidelines to the participants. Then, the programs should be operated under those guidelines.

Loan procedures should clearly identify the person in charge of the loan program, the basis for loan approval, any limitations on the types and amounts of loans offered, the procedure for determining a reasonable rate of interest, the collateral that will secure the participant loan (typically, the participant's account), the events constituting a default, and the steps that will be taken if a default occurs. Participants should be given forms to apply for loans. The applications should be filed with the committee or a representative named by the committee. Applications must be reviewed to make sure they are complete and that the participant is eligible for a loan under the guidelines. If the participant meets the criteria for a loan, and the loan is granted, the participant must sign a promissory note with the terms of repayment. The loan would then be made from the participant's account. The committee is responsible for overseeing those procedures, as well as the repayment of the loan. Most plans require that the loan be repaid through payroll withholding. In such cases, the employee will also need to sign a form consenting to the withholding. The timing for contributing loan repayments paid through withholding are the same as for elective deferrals (*i.e.*, as soon as they can reasonably be segregated from the employer's general assets).[61]

If your plan allows hardship withdrawals, the committee should adopt a policy, consistent with the plan provisions, with the criteria and procedures for hardship withdrawals. Like the loan guidelines, this policy must be administered in a prudent manner with equal treatment for all participants.

[61] DOL Advisory Opinion 2002-02A.

Qualified Domestic Relations Order

If a participant's marriage ends with a divorce or legal separation, the family law court may issue an order to divide the retirement benefits (referred to as a domestic relations order or "DRO"). The court order ordinarily gives the former spouse of the participant an interest in the participant's benefits. The law calls the non-participant spouse an "alternate payee." A plan cannot make a distribution to the participant's former spouse without a court order that meets the legal requirements. In other words, the court order must be "qualified."

A "qualified" domestic relations order ("QDRO") is a court order that satisfies specific requirements under the Code. Under the law, the administrator of the plan (*i.e.*, the plan sponsor or committee appointed by the plan sponsor) is responsible for determining whether a domestic relations order meets the legal requirements to be a QDRO. If the domestic relations order does not, it must be rejected, and no distribution made until it is correct. A plan must establish written procedures to determine the qualified status of domestic relations orders and to administer distributions pursuant to qualified orders. Many plans prepare a form QDRO to be given to participants to assist them in complying with the requirements. Once the administrator determines that the order issued is a QDRO, it is permitted to proceed with the division of the participant's benefits and, if the plan permits, with the distribution to the alternate payee under the QDRO's terms.

Employee Classification

The committee needs to make sure that the plan covers all employees who satisfy the eligibility requirements. Most of the time, it is obvious who is entitled to be in the plan, but not always. Under the Code, all employees of companies that share significant common ownership, or are affiliated in the services they provide, are treated as employed by a single employer. In that situation, the employees of a related company may be excluded, but only if the plan document provides for that and if the tax rules for coverage are satisfied.

While these rules are complicated and often require professional help to be applied to related companies, it is the committee's responsibility to make sure that all the employees who are entitled to participate are given that opportunity. Whenever the company sponsoring the plan has related entities—subsidiaries, parent companies, brother-sister entities or companies in which key people own an interest and which provide a service for the employer—these rules should be reviewed and their impact on the plan should be determined. It is also important to know what the plan document says about related companies and the coverage of their employees.

Contingent Workforce Issues

An area receiving increased attention and requiring fiduciary oversight by the plan committee is the “contingent” workforce issue. Nontraditional employment relationships have gained popularity as employers try to operate more cost-effectively. The workers employed in these nontraditional working relationships are sometimes labeled “contingent workers.” They could include, for example, temporary workers, provisional employees, freelancers, co-employees, leased employees, agency employees and independent contractors. These workers may or may not be employees of the employer from an ERISA perspective and may or may not be eligible to participate in the plan. Failure to include eligible workers—or the inclusion of ineligible workers—can be a costly mistake—both in terms of endangering the plan’s tax qualification and in terms of the additional contributions needed for “employees” who should have been allowed to participate.

The problem may be identified as a result of an IRS payroll tax audit. If the IRS determines that workers who are treated as independent contractors who are classified as a type of “special” employee—whatever label is given to them by the employer—are actually common law employees of the employer, then the plan may be obligated to cover these employees—at considerable expense to the employer. As employees, they will be entitled to participate in the plan retroactively if they have met the plan’s eligibility requirements. The plan committee’s oversight of this issue is important not only when the plan is adopted, but also as the nature of the workforce changes over time.

A properly drafted plan can often eliminate the problem or at least significantly reduce its impact by providing that, if workers are reclassified as employees—by the IRS in a payroll tax audit, for example—it is still the employer’s intent not to provide benefits to them under the plan.

Reporting and Disclosure

A key principle of ERISA is that plans must maintain records of their activities and provide information on their operations to participants and must report their activities to the government. These are called the “reporting and disclosure” rules—that is, plans must disclose important information about their operation to the participants and to the government. ERISA and the Code impose a number of requirements for annual reporting of the status of the plan.

Government Reporting

The most important reporting and disclosure documents are: the Form 5500 annual report filed with the DOL and IRS; the summary annual report, or SAR, given to the participants each year; and the summary plan description, or SPD, which describes the terms of the plan to the participants in easily understood language. The purpose of this section is not to describe these reports but to mention them and to explain your duties.

Form 5500 must be filed with the DOL within seven months (nine and one half months with an extension) after the end of each plan year. The DOL sends a copy of the report to the IRS. Both agencies use the Form 5500 to select plans for examination. Your duty regarding the Form 5500 is to make sure it is prepared and filed on a timely basis and that the information in the Form is accurate. Before signing the completed Form, you need to read it, make sure you understand what it says about the plan and its operations, and ask questions about anything you do not understand. The Form is signed “under penalty of perjury;” as a result, you should be confident that the answers and information in the Form are all accurate and complete.

For plans with 100 or more participants, the Form 5500 must include an accountant’s report. The committee is responsible for selecting the plan’s accountant. Accordingly, you should review the credentials and experience of the accountants being considered to do the audit to make sure they are qualified to audit plans, review their engagement letter to understand the scope of the audit and that it is consistent with the legal requirements, and evaluate the cost to make sure it is reasonable. Once the report is delivered, you should review it and any accompanying letter from the accountants and ask questions about anything you do not understand.

All Plan Year 2009 and later Form 5500 filings must be filed electronically through the Department of Labor's ERISA Filing Acceptance System (EFAST2). Once filed, your 5500 Forms become public records available for review and dissemination.

Bond and Fiduciary Liability Insurance

As mentioned in the “Fiduciary Liability Insurance and ERISA Fidelity Bond” section of “Understanding My Liability,” the committee should make sure the plan has a bond—generally referred to as a “fidelity bond”—covering the people who handle plan assets.

Another way to protect the plan and the participants is for the employer to obtain fiduciary liability insurance. NOTE FOR FEDERAL CREDIT UNIONS: Federal credit unions acting as fiduciaries are required under the National Credit Union Administration rules to have fiduciary liability insurance.[62]

[62] NCUA Reg. § 701.19(b).

How CUNA Mutual Group Can Help

CUNA Mutual Group is here to assist you in understanding your responsibilities as they relate to the administration of your plan. Plan administration includes both the Code requirements and ERISA rules. Here are some of the products and services available to you.

Services

Plan Documents. CUNA Mutual Group assists plan sponsors in keeping current with all regulatory requirements. Included in that is providing plan sponsors with a pre-approved plan document. For example, one type of pre-approved plan CUNA Mutual Group provides is a prototype plan. A prototype plan consists of a basic plan document which contains all of the non-elective provisions of the plan and a separate adoption agreement which contains all of the options that may be selected by the plan sponsor. CUNA Mutual Group submits the basic plan document and the adoption agreements to the IRS National Office and receives an opinion letter that the form and language of the plan documents are acceptable.

Testing. CUNA Mutual Group monitors all regulations pertaining to plan documentation, summary plan descriptions, enrollment forms, nondiscrimination testing, and the preparation of IRS Form 5500. CUNA Mutual Group's compliance testing experts provide efficient service to ensure that your plans comply with the annual nondiscrimination and compliance testing regulations, including consultation on the results of your ADP/ACP testing. CUNA Mutual Group provides guidance with deciding what corrective action makes the most sense for your organization, along with assistance in increasing plan participation to avoid testing failures in the future. Some of the options discussed with plan sponsors include:

- plan design changes including matches
- safe harbor alternative
- automatic 401(k) features
- communication and education programs
- targeted communications to eligible non-participants and/or low-deferral participants

Compliance Guidelines

Qualified Domestic Relations Order (QDRO) support. CUNA Mutual Group can provide sample QDRO documents that you can share with participants. These sample documents can help their legal counsel draft a comprehensive QDRO document that meets the IRS requirements as well as protects their plan rights. In addition, we provide our plan sponsors an easy to follow checklist for accurately administering a final QDRO document.

Employee Classification and Contingent Workforce Issues. It's critical that you understand how the right plan provisions can support the unique needs of your particular employee group. CUNA Mutual Group will conduct a comprehensive plan design consultation with you to make sure you understand the IRS and DOL regulations on excludable employee classifications. We'll work with you to make sure your plan design meets your objectives and conforms to legislative guidelines. This personalized level of consultation occurs not just at the point of sale, but on an ongoing basis to assure your plan continues to meet the needs of your changing workforce.

Reporting and Disclosure. CUNA Mutual Group assists plan sponsors with their compliance issues by preparing a Summary Annual Report for the plan. In addition, CUNA Mutual Group uses a program that captures the plan sponsor's financial information and imports that information in the Form 5500 to assist the plan sponsors in preparing and filing its 5500 through the DOL's EFAST2 filing system.

Additional Information

[Prohibited Transaction Rules]

[Case Studies]

[How CUNA Mutual Group Can Help]

Avoiding Prohibited Transactions

Both ERISA and the Code include absolute restrictions on using plan money to benefit the employer and other related persons and entities. These are called the "prohibited transaction" rules. While these rules are complex in their own right, they are further complicated by a series of statutory and administrative exemptions. The penalties for prohibited transactions are severe. So, if there is a suspicion that a transaction could be a prohibited transaction, the fiduciaries should avoid the transaction or, alternatively, seek the advice of counsel before entering into the transaction.

The practical keys to avoiding prohibited transactions are:

- Always do what's right for the participants.
- Never deal with a related person or affiliated entity.
- Never personally benefit from any plan activity, except as a participant.
- In some cases, there are exceptions to those rules, but detailed and literal compliance with their conditions is required. Don't attempt to use an exception without expert advice.

Prohibited Transaction Rules

The prohibited transaction rules forbid certain transactions with persons and entities that are closely related to the plan ("parties in interest"). In addition they specifically prohibit self-dealing transactions by the fiduciaries. The definition of party in interest includes:

- Plan fiduciaries;
- Owners;
- Employer sponsoring the plan;
- Relatives of plan fiduciaries;
- Any person providing services to the plan.[63]

The following are some of the transactions with a party in interest that are prohibited:

- The sale, exchange or lease of property;
- Loans or other extensions of credit;
- The furnishing of goods, services or facilities;
- The transfer or use of plan assets.[64]

Keep in mind, though, that in some cases there are exceptions to these restrictions.

In addition to the transactions above, ERISA's prohibition against fiduciary self-dealing prohibits fiduciaries of a plan from: dealing with the assets of the plan for their own benefit, representing any party with interests adverse to the plan in a transaction, or receiving consideration from a service provider or party in interest in connection with a transaction with the plan.[65]

There is a misconception that transactions which benefit the plan or the employer—and which otherwise indirectly benefit the employees—must be okay, even if the transactions involve related parties. But that's not the case. It doesn't matter if the transaction is reasonable or even if it benefits the plan—it is absolutely prohibited. Even if the prohibited transaction seemed reasonable when it was entered into, it is still a violation of the law and can result in substantial penalties and personal liability for the fiduciaries. No bad intent or evil motive is required to prove a prohibited transaction.

[63] ERISA § 3(14).
[64] ERISA § 406(a).
[65] ERISA § 406(b).

Exemptions

Under the prohibited transaction rules, a fiduciary may not cause or allow the plan to enter into prohibited transactions. However, there are three kinds of exemptions from the prohibited transaction rules:

- Statutory exemptions are included within ERISA and its regulations. An example is the exemption under ERISA Section 408(b)(2) for using plan assets to pay reasonable fees to service providers.
- Class exemptions are issued by the Department of Labor and are available to anyone who meets the requirements of the exemption.
- Administrative exemptions are requested by individuals under special circumstances and apply only to that individual.

One example of an exemption is the statutory exemption for participant loans under ERISA Section 408(b)(1). As noted earlier, under ERISA a plan is prohibited from lending money or extending credit to a party in interest. However, plans may make loans to a participant, provided that the loan program:

- Is available to all participants on a reasonably equivalent basis;
- Is not made available to highly compensated employees, officers or shareholders in an amount (or percentage) greater than that made available to other participants;
- Is made in accordance with specific plan provisions;
- Provides for loans with a reasonable rate of interest; and
- Requires adequate security for the loans.

Penalties

The DOL and the Internal Revenue Service include the following taxes and penalties for fiduciary breaches and prohibited transactions. Keep in mind that fiduciaries may be held personally liable for payment of the taxes and penalties.

- **Civil penalty:** 20% of amount recovered due to a prohibited transaction, if the amount is collected due to DOL intervention. This penalty is in addition to the amount necessary to correct the breach.
- **Tax:** 15% of amount involved in each prohibited transaction. If the prohibited transaction is not corrected in a timely manner, an additional tax of 100% may be assessed. Severe violations of prohibited transaction rules could also result in a violation of the "exclusive benefit rule," which could cause the Internal Revenue Service to disqualify the plan.

PARTICIPANT LOANS

In an advisory opinion, the DOL concluded that participant loan repayments paid to or withheld by an employer are similar to participant deferrals and, in the absence of regulations providing otherwise, the application of principles similar to those that govern to the timing of deferral deposits apply. Specifically, the Advisory Opinion concluded that participant loan repayments paid to or withheld by an employer for purposes of transmittal to the plan become plan assets as of the earliest date on which such repayments can reasonably be segregated from the employer's general assets.[66]

[66] DOL Advisory Opinion 2002-2A.

Avoiding Prohibited Transactions

Avoiding Self-Dealing

Plan assets must be managed and invested for the benefit of participants and their beneficiaries. They must be held for the exclusive purpose of providing benefits to participants and beneficiaries and defraying reasonable expenses of administration of the plan, and no one else (and especially not the employer or any other fiduciary) should receive a personal economic gain from the plan assets. This imposes a duty on the fiduciaries never to use their power for their own personal gain.

If you always discharge your duties exclusively toward providing participants with retirement benefits and do not receive any personal benefit from your decisions, any concern with “self-dealing” can be avoided. You also need to be on guard against dealings in which plan assets can benefit a fiduciary or others who have dealings with the plan. For example, the employer should not borrow money from the plan. Parties who are closely related to the plan should not buy assets from, or sell assets to, the plan because of the potential conflict of interest. A fiduciary should not receive a personal benefit from the plan or from a third party dealing with the plan in connection with plan transactions. The overriding concept is to act solely in the interest of participants to provide them with retirement benefits.

Avoiding Prohibited Transactions

Case Studies

PROHIBITED TRANSACTION #1

Situation:
The CEO of Acme Company (a fiduciary of the plan) causes the plan to hire his son Walter as the investment adviser for the plan.

Result: The CEO has engaged in a prohibited transaction under Section 406(b)(1) of ERISA.

Why: Section 406(b)(1) prohibits a fiduciary from dealing with plan money in his own interest or for his benefit. Since Walter is the son of the CEO, Walter is a person in whom the CEO has an interest which may affect his ability to exercise his best judgment as a fiduciary.

PROHIBITED TRANSACTION #2

Situation:
The Acme Company plan committee hires ABC Services to provide administrative services to the plan. ABC Services' fees are twice the fees charged by its competitors for the same services.

Result: The Acme Company has engaged in a prohibited transaction.

Why: A contract with a provider to a plan is permissible under the prohibited transaction rules and the exceptions if the service is necessary and appropriate for the operation of the plan and if the fees and expenses are no more than reasonable. A contract will not be considered reasonable unless the service provider discloses in writing in advance of the arrangement the services, compensation and fiduciary status of the provider. If the provider does not make such disclosures, the arrangement with the service provider is prohibited. Alternatively, if the service provider disclosed its fees, but if it turns out that the fees being paid to a service provider are excessive, then the unreasonable amount of those fees is a prohibited transaction and creates the possibility of damages and penalties. In this case, the fees charged by ABC Services are twice the fees of its competitors for the same services and therefore excessive. If the service provider charges a reasonable fee but fails to make the required disclosures, the plan fiduciary may also be liable for a prohibited transaction unless the fiduciary reasonably believed he had received all of the required information and requests the missing information upon discovering the omission.

Avoiding Prohibited Transactions

PROHIBITED TRANSACTION #3

Situation:
Acme Company kept employee deferrals because it needed to meet cash flow for payroll and for other purposes in order to keep their business going. It never intended to keep the money forever; it was just to help with cash flow.

Result: The failure to deposit salary deferrals on a timely basis constitutes a prohibited transaction subject to excise tax under the Code. In addition to the payment of tax, the employer must correct the transaction. Correction requires the restoration of lost income resulting from the late deposit of amounts to the trust.

The prohibited transaction continues until corrected and both IRS and DOL penalties apply. By engaging in a prohibited transaction, Acme Company is required to pay the prohibited transaction excise tax and to correct the transaction. The excise tax is 15% of the amount involved in the prohibited transaction for each year or portion of a year during the “taxable period” of the transaction. The taxable period begins on the date of the prohibited transaction, and ends on the date the employer completes correction of the transaction. In this situation, where the prohibited transaction is a loan, an additional prohibited transaction arises on the first day of each succeeding taxable year during the taxable period. If the plan sponsor, during a given year, does not pay the interest on the loan, according to the IRS the interest becomes part of the principal amount in the subsequent year.

In addition to the fees assessed by the IRS, an ERISA Section 502(l) penalty is assessed when the amount recovered is pursuant to a settlement with the DOL or a court order. Section 502(l) imposes a penalty of 20 percent of the amount recovered by the DOL from a fiduciary who breaches his fiduciary duty or commits another violation of ERISA, such as a prohibited transaction.

Why: Employee deferrals must be remitted to the Plan as of the earliest date on which the contributions can reasonably be segregated from the employer’s general assets. By delaying the deposit of the employee deferrals in order to use that money for payroll, Acme Company has engaged in a prohibited transaction.

Prohibited Transactions: Self-Dealing

SELF-DEALING TRANSACTION #1

Situation:
Acme Company's investment adviser is a golfing partner of the CFO (who is a member of the plan committee). The investment adviser offers the CFO a discount on her personal investments if the adviser's investment firm is selected to manage the plan's assets. The CFO says that sounds like a great idea, because she could use a discount on those fees. At the next meeting of the plan committee, the committee votes to change investment advisers based on the CFO's recommendation.

Result: Her action constitutes both a prohibited transaction and a fiduciary breach.

Why: By accepting this offer, even if the investments the adviser recommends perform favorably for the plan, the CFO has used the plan assets for her benefit.

SELF-DEALING TRANSACTION #2

Situation:
Acme Company would like to expand its services. The service it would like to provide is outside the scope of its tax-exempt purpose, so Acme Company creates a taxable partner called Acme Credit Services. Acme Company and Acme Credit Services have a single 401(k) plan that covers the employees of both entities. Acme Credit Services would like to act as a selling agent for investments under the 401(k) plan and receive commission on investment transactions.

Result: By receiving the commission, Acme Credit Services is receiving consideration for the sale of services to the plan and this is a prohibited transaction.

Why: In their capacities as employers, both Acme Company and Acme Credit Services are fiduciaries of the plan. As a fiduciary of the plan, Acme Credit Services is a party in interest and under the prohibited transaction rules there can be no direct or indirect sale or exchange of property or furnishing of goods and services between the plan and a party in interest.

How CUNA Mutual Group Can Help

CUNA Mutual Group helps you avoid prohibited transactions by educating you on what they are. This fiduciary guide lists several examples of prohibited transactions. If you just aren't sure if something you would like to do is prohibited or not, contact our team of specialists at the **Retirement Service Center** toll-free 800.999.8786, option 1 or send an email to prc_mail@cunamutual.com.

CUNA MUTUAL GROUP

Educating Our Employees

Additional Information

[Helping Participants by Including Certain Investments]

[Investment Education or Investment Advice]

[How CUNA Mutual Group Can Help]

Educating Our Employees

Investment education, investment advice, or both – what is best for my participants? ERISA does not specifically require that plan sponsors or fiduciaries offer investment education…nor investment advice or asset allocation models. Instead, ERISA imposes the “prudent person” rule – that is, what would a prudent fiduciary do when faced with the reality that many of the participants don’t understand the basics of investing? The only course of action that is clearly safe for fiduciaries is to assume that participants must be given the products and services necessary to properly invest for retirement.

By evaluating your participant population, determining what features would adequately assist that population in achieving adequate retirement savings and implementing those features, plan fiduciaries will go a long way towards achieving a successful plan.

Helping Participants by Including Certain Investments

As discussed in "Limiting My Liability," a fiduciary is not only liable for selecting and monitoring the investments, he is also liable for the investments made by participants (if the plan does not comply with 404(c)). So in selecting the investments, the fiduciaries should focus on whether the investment lineup will enable the participants to assemble portfolios of prudently selected investments that properly balance their risk and return needs. For a workforce with little investment experience, this may mean offering a limited array of investment choices, including managed options such as lifestyle or lifecycle funds. On the other hand, for a knowledgeable group of employees, it may mean that a large, varied, and complex investment lineup can be offered.

An asset allocation fund (*e.g.*, lifestyle fund, lifecycle fund) invests in several funds representing different asset classes and investment styles normally invested in separate funds. With an asset allocation fund, a portfolio manager makes the asset allocation decisions. In a participant directed plan, such funds can provide some assurance that participants, especially those ill-equipped to make asset allocation decisions, will be well-invested.

Investment Education or Investment Advice

Investment Education

Providing investment education does not make an individual a fiduciary, but providing investment advice does. In Interpretive Bulletin 96-1 (IB 96-1), the DOL provided guidance on how a plan sponsor can provide investment education to participants without giving fiduciary investment advice. IB 96-1 provides guidance on when investment information and materials constitute investment advice and when that information falls outside of that standard (*i.e.*, when it is nonfiduciary investment education). The Bulletin has one continuing reminder: avoid recommendations of specific funds or investments or you will convert investment education into investment advice.

Broadly stated, investment education (as opposed to investment advice) can cover:

- Plan information;
- General financial and investment information;
- Asset allocation models; and
- Interactive investment materials.

Thus, the degree of assistance that may be offered without becoming a fiduciary is quite broad. In fact, the DOL states in the preamble that "merely because participants and beneficiaries receive personal assistance in developing model asset allocations" does not make the information investment advice.

The purpose of investment education is to teach the participants about the basics of investing. But, before fiduciaries implement an investment education program, they need to assess the needs of the employees. After the program has been put in place, it should be regularly reviewed for effectiveness and investments.[67]

Generally, data on the investments is prepared by others—for example, by the firm that provides your investments. Initially that information is provided to participants at enrollment meetings. However, if the participants do not understand basic investment concepts, the data about the investments may be of minimal value.

[67] DOL Interpretive Bulletin 96-1.

Educating Our Employees

So, you need to determine if participants are able to use the data effectively. If participants are not ready for their investment responsibilities, they cannot be expected to make well-reasoned choices. If they do not have an understanding of basic investment concepts, they may need investment education on the fundamentals before they can manage their retirement funds. Participants should understand the following: What is a stock? What's a bond? What is a mutual fund? What impact do fund expenses have on the investment results? Why should investments be diversified?

WHAT INFORMATION SHOULD MY PARTICIPANT EDUCATION PROGRAM PROVIDE?

The following information is commonly provided in a participant education program:

- The benefit of participating in the plan and saving for retirement;
- The impact of pre-retirement withdrawals, such as loans or hardship withdrawals;
- General financial and investment concepts, such as risk and return, diversification, dollar-cost averaging, compounded return and tax-deferred investment;
- Historical differences in rates of return of various asset classes;
- Effects of inflation;
- Estimating future retirement needs;
- How to determine investment time horizons;
- How to assess risk tolerance;
- Asset allocation models based on hypothetical participants with different time horizons and risk profiles;
- Interactive investment materials, such as questionnaires, worksheets or software which permit participants to estimate their retirement needs and assess the impact of different asset allocations on their retirement income.

PRACTICAL TIPS

Monitoring Your Investment Education Program

ERISA requires that fiduciaries evaluate the providers of investment education, understand the content and delivery of those services, and monitor the effectiveness and quality of the education.

1. Obtain information on the investment behavior of the participants and changes in that behavior from year to year, and then evaluate that information to determine if the investment educational and enrollment meetings are working.
2. Do many—or even most—participants use risk-based lifestyle funds as if they were just another investment option? For example, do participants often, or even typically, invest only parts of their accounts in lifestyle funds—which are meant to be, in and of themselves, a prudently balanced portfolio for a participant's account?
3. Are many participants invested primarily or entirely in a single asset class, such as:
   i. stable value?
   ii. money market accounts?

Item 3 is significant because ERISA contemplates that participants will be invested in multiple asset classes to balance risk and reward. In other words, participants need to be in equities for future growth and in fixed income, stable value or money market accounts to lessen volatility and risk. However, each participant needs to invest in a manner in which they balance those factors appropriate for themselves. Part of the role of investment education is to teach them how to do that.

Educating Our Employees

PRACTICAL TIPS

In order to effectively evaluate the investment education sessions and new employee enrollment meetings, committee members should attend them as well as reviewing the materials.

After the meetings, the committee should discuss whether it believes that any changes are necessary. For example, they may find that many of the employees are asking very basic questions, which suggests a significant lack of investment knowledge. As a result, the fiduciaries may decide to have the enrollment or education meetings focus on investment solutions, such as asset allocation models, risk-based lifestyle funds or age-based lifecycle funds.

Investment Advice

In some cases, communication and investment education may not be enough. Some employees may still be uncomfortable making investment choices. In those cases, the fiduciary should consider offering investment advice to the participants.

Changes to ERISA and the Code by the Pension Protection Act of 2006 have helped to encourage investment advice for participants by creating an exemption from the prohibited transaction provisions of ERISA and the Code that have been perceived as an impediment to providing such advice. Under the new law, there are two situations in which a fiduciary adviser will not engage in a prohibited transaction if it gives investment advice to participants: (1) the adviser's compensation is "level" - that is, the amount the adviser receives for giving the advice remains the same no matter what advice is given and how the participant invests his account; or alternatively (2) the advice is given through a computer model, in which case, the adviser's compensation does not have to be level.

As mentioned earlier, the purpose of investment education is to teach the participants about the basic tools for investing...the purpose of investment advice is to point them to specific funds. The most common approach for giving participants investment advice is through an Internet investment advisory service.

The decision to offer investment advice, regardless of the form, is a fiduciary decision - and thus must be made prudently. However, the decision to not offer investment advice is also a fiduciary decision and, whether made by action or inaction, must also be made prudently. Plan sponsors and fiduciaries should consider the needs of employees and, if investment advice is appropriate, investigate and evaluate the credentials and abilities of the investment adviser. If the investment advice is appropriate, the fiduciaries should implement the investment advice program knowing that the best defense is a good offense - that is, if the advice enables your participants to invest according to sound and commonly-accepted principles, the law's requirements will be satisfied and, as a result, there will not be a need for a defense.

Educating Our Employees

As discussed in "My Fiduciary Responsibilities," a fiduciary's duty does not end with the selection of the investment adviser. You need to monitor the service to determine if it is performing properly. That includes an evaluation of whether the investment adviser is providing good service to the participants, whether the adviser's models are performing properly, and whether any changes have occurred in the underlying approach. The investment adviser should give you the information you need to review, such as descriptions of their investment models; an explanation of their investment approach and methods; the data they take into account in rendering their advice; their past performance; and the ease of use of their service. In selecting an adviser, check references from other plan sponsors and in monitoring an adviser, check with your employees about their satisfaction with the service.

Educating Our Employees

How CUNA Mutual Group Can Help

Helping your employees attain a financially secure retirement should be the main goal of any retirement plan, and it is what CUNA Mutual Retirement Solutions is all about. We offer a wide range of educational opportunities for your employees from live financial advisers that can offer personal guidance, to self-service education on the web. Here is a list of some different resources.

Plan Features

The following plan features available for your plan.

- Easy online enrollment
- Automatic enrollment and automatic savings increase options
- Target Date and Target Allocation fund options

Online Educational Resources

Financial planning tools and calculators can be found on the *Reaching My Goals* page of the participant website. Some of these calculators can also be found under *Reaching Our Goals* on the *Provide Educational Tools and Resources* page.

Personal Guidance with a Licensed Financial Adviser

Our experienced team of licensed financial advisers at the Investor Guidance Center are available to provide free-of-charge to your employees the following services:

- retirement planning and strategy
- portfolio planning and asset allocation
- designing a retirement income plan
- use of planning tools available on our *Benefits for You* website for participants
- education on taxes that should be considered in retirement planning

The team can be accessed on the phone at 800.999.8786, or through email at psu@cunamutual.com.

Educating Our Employees

Employee Communications and Training Sessions

Keeping your employees informed about their investment options and to learn best practices for training is an essential part of helping them attain a financially-secure retirement. Regular communications is one way to keep your employees informed. CUNA Mutual Group helps you with communications and training through the following resources:

- Quarterly newsletters
- Quarterly webinars
- Quarterly Statements
- Face to face or remote education sessions with a Retirement Education Specialist

CUNA Mutual Group also makes posters, flyers, and other communications available for you to choose from, download and forward onto your employees yourself. You can find this information on the *Reaching Our Goals* page under the *Providing Educational Tools and Resources.*

Examples of Fiduciary Violations

Additional Information

Failure to Timely Deposit Deferrals

Failure to Regularly Monitor Investments

Failure to Understand and Analyze Plan Fees and Expenses

Failure to Engage in a Prudent Process

Failure to Participate in the Process – Inaction of Committee Members

As mentioned earlier, this resource center is provided as a guide to help you understand your fiduciary responsibilities for the operation of your retirement plan. Equally important is understanding what happens when you fail to take action or act contrary to your duties. The following pages provide illustrated examples of mistakes that are often made by plan sponsors and fiduciaries. These examples serve two purposes: the first is to warn you and other plan sponsors about common areas where mistakes occur and to give examples of where other plan sponsors have gotten it wrong so that you understand how to do things right.

FAILURE TO TIMELY DEPOSIT DEFERRALS

The situation: A company sponsors a 401(k) plan that permits employees to defer from their bi-monthly paychecks. The company uses an electronic payroll system and is able to segregate the deferrals within 4 days after each pay period. Instead of depositing the deferrals into the plan shortly after each pay period, the company holds those deferral amounts in its general funds until the end of the month so that it can submit the deferrals for the entire month at once.[68]

The rule: The company is responsible for withholding contributions and submitting them to the Plan. Amounts deferred by participants become plan assets on the earliest date on which the contributions can reasonably be segregated from the general assets of the company. In any event, that date can be no later than 15 business days after the end of the month in which the contributions are withheld by the company.[69] For small plans (those with less than 100 participants at the beginning of the plan year), the Department of Labor has created a safe harbor for submitting contributions if the deferrals are contributed no later than the 7th business day following the day they were withheld.[70] For employers who can't, or don't, comply with the safe harbor, as a practical matter, if the deferrals are not deposited within 7 to 10 days (or less if the company's practice indicates that deferrals can be deposited within a shorter period of time) after being withheld, the conduct of the company and the fiduciaries may be challenged by the U.S. Department of Labor, or by the employees. (The Department of Labor is the government agency responsible for enforcing ERISA.)

Consequences: The failure to timely deposit deferrals is a prohibited transaction–because the plan sponsor is considered to be using plan assets for its own benefit.[71] The plan sponsor could be liable for the greater of any losses resulting from the prohibited transaction or any gains made by it in using those assets, as well as penalties under the law.[72]

The failure to timely deposit deferrals is also a fiduciary breach because the plan assets are not being held in trust as required by ERISA and because the assets are not being invested to provide benefits for the participants. Fiduciaries must act solely in the interest of the participants and beneficiaries of the plan. Therefore, the fiduciaries have a duty to deposit deferrals into the trust and to prudently invest that money. As a result, fiduciaries are responsible for any losses that occur because of the late deposits, or the failure to deposit, employee deferrals.

[68] See, *McConnell v. Costigan*, 2002 WL 313528 (SDNY 2/29/02); Rev. Rul 2006-38.
[69] DOL Reg § 2510.3-102(a).
[70] DOL Reg § 2510.3-102(a)(2).
[71] ERISA § 406(b)(1) and Code § 4975(c)(1)(E).
[72] ERISA § 502(l) and Code § 4975; See also, Rev. Rul. 2006-38.

Examples of Fiduciary Violations

PRACTICAL TIP

The late deposit of deferrals has been, and continues to be, the DOL's top enforcement priority for retirement plans. As a matter of common practice, DOL investigators examine the pattern of the deposit of the deferrals into the plan. The DOL then uses the most prompt deposits of proof of what the company was capable of doing. (Of course, if all the deposits were slow, the DOL would use a different benchmark.)

In situations where a company did not promptly deposit all of the deferrals, the DOL investigators will require the company to justify the later deposit. Plan sponsors may be able to justify those later deferrals by demonstrating reasonable cause, such as change of payroll providers, computer problems, and so on. However, that justification would need to be adequately documented to the DOL.

FAILURE TO REGULARLY MONITOR INVESTMENTS

The situation: An employee is appointed to her company's 401(k) plan committee. The plan's investments have already been selected. Subsequent to her appointment, the committee does not monitor the plan investments.

The rule: The selection of investments for a 401(k) plan is a fiduciary act.[73] Although a fiduciary is not a "guarantor" of the success of plan investments, the fiduciary has an initial duty to prudently select the investments and an ongoing duty to prudently monitor them. Typically, that monitoring process involves, among other things, the comparison of the investment performance of the options to: (1) the appropriate benchmark index for each fund (for example, the S&P 500 Index for mutual funds investing in large U.S. companies, the Russell 2000 Index for mutual funds investing in small U.S. companies, and so on); (2) the appropriate peer group (for example, the average large company growth fund, the average small company growth fund, the average small company value fund, and so on); as well as an analysis of (3) the quality of the investment manager of a mutual fund; and (4) the fees and expenses charged for the investments.

Whether the fiduciary has any liability for investment losses will depend on whether the fiduciary fulfilled its responsibilities to engage in a prudent process to select, monitor, remove and replace the plan's investments.[74] In this case, the committee members clearly failed to monitor the investments.

Consequences: The failure to monitor and the failure to remove a fund – when required, are both fiduciary breaches under ERISA. A fiduciary breach can result in personal liability for the plan fiduciaries. The individuals who select the investment options – and have the duty to monitor them – are ERISA fiduciaries (even if they are not designated as fiduciaries by the plan). Further, the officers and directors who have oversight responsibility (such as those who appointed the investment committee members) have a duty to monitor the performance of the plan fiduciaries. If they do not, then they can be jointly and severally liable for any losses which occur as a result of a failure to monitor.[75]

[73] Preamble to DOL Regs. 29 C.F.R. 2550, 57 FR 46906, 46924 n. 27.
[74] http://www.dol.gov/ebsa/publications/fiduciaryresponsiblity.html; *Donovan v. Mazzola*, 716 F.2d 1226 (9th Cir. 1983); *Donovan v. Cunningham*, 716 F.2d 1455 (5th Cir. 1983).
[75] http://www.dol.gov/ebsa/publications/fiduciaryresponsibility.html

Examples of Fiduciary Violations

PRACTICAL TIPS

Plan Sponsors should:

1. Appoint a plan investment committee. In our experience, the appointment of a committee is evidence of good governance practices by the board of directors. In addition, the existence of a plan committee which meets regularly (*e.g.*, quarterly) is material evidence of procedural prudence.
2. The plan investment committee should:

   a. Obtain information about the investments. The information should include both qualitative and quantitative data. Qualitative information includes, for example, the reputation and stability of the investment manager for a mutual fund. Quantitative data includes past performance and expenses – which are typically compared to the average data for similar funds.

   b. Review that information;

   c. Discuss that information at a committee meeting;

   d. Make a decision reasonably based on that information and analysis;

   e. Prepare minutes of the meeting, including the decisions; and

   f. Maintain the minutes and the information for at least 6 years.

The plan investment committee may also consider hiring an adviser to provide it with information and advice regarding the plan's investment options. Hiring a third party expert to provide guidance can illustrate that the committee is acting prudently when selecting and monitoring investments.

FAILURE TO UNDERSTAND AND ANALYZE PLAN FEES AND EXPENSES

The situation: The company was considering selecting a new provider for its 401(k) plan. During the process, several providers were considered, but the company ultimately decided to continue with its current provider. As part of its selection process, the company did not determine and analyze the fees and expenses of the providers. Among the providers considered, the current provider had the highest cost.

The rule: Although a plan sponsor does not have to select the lowest cost provider, the sponsor must consider the provider's fees in it selection process. In selecting providers, the sponsor is responsible for ensuring that the expenses of the plan, including amounts paid directly or indirectly to the providers, are reasonable in light of the needs of the plan and the level and quality of the services provided.[76] In order to make that decision, the sponsor must learn about the fees and expenses of the provider and compare those fees to competitive costs.[77]

Consequences: By law, plan assets may only be used to pay for reasonable expenses for administering the plan and investing its assets. Fiduciaries will breach their duties if they permit unreasonable fees to be paid. Also, the participants' benefits will unnecessarily be reduced by the excessive expenses. Plan expense issues have generated a recent surge in litigation with over two dozen lawsuits filed alleging breaches associated with excessive or improper fees. Under recently issued regulations, by July 2011, service providers will be required to disclose to plan fiduciaries in writing all compensation the provider will receive for service to the plan.[78]

[76] DOL Publication, *A Look at 401(k) Plan Fees* at http://www.dol.gov/ebsa/publications/401k_employee.html.

[77] DOL Advisory Opinion 97-16A (May 22, 1997)(Issued to ALIAC, an insurance company offering services to 401(k) plans.) "In this regard, the responsible Plan fiduciaries must assure that the compensation paid directly or indirectly by the Plan to ALIAC is reasonable, taking into account the services provided to the Plan as well as any other fees or compensation received by ALIAC in connection with the investment of Plan assets. The responsible Plan fiduciaries therefore must obtain sufficient information regarding any fees or other compensation that ALIAC receives with respect to the Plan's investments in each Unrelated Fund to make an informed decision whether ALIAC's compensation for services is no more than reasonable." See also, DOL Field Assistance Bulletin 2002-3 requiring independent fiduciary review of service provider's retention of "float."

[78] DOL Reg §2550.408b-2

PRACTICAL TIP

The plan sponsor, in its fiduciary capacity should determine the total cost of the plan in dollars, including the cost of all the investments as well as the cost of all the services. One approach to doing this is for the plan sponsor to ask competing providers to tell it the total cost for their services (for example, through a request for proposal (RFP) or request for information (RFI) process). If it is not a competitive situation, but the plan sponsor is monitoring the plan on an ongoing basis, then the plan sponsor should determine the total cost as of the prior year end. That information should be compared to market data for similarly-situated plans (for example, through the use of a benchmarking service).[79] Under new regulations, service providers must generally disclose all compensation the provider will receive with respect to services provided to a plan.[80] This affirmative obligation should help fiduciaries with the process of understanding and comparing the cost of plan service providers—though it also means that fiduciaries will need to review and evaluate the information they receive.

The total cost should be divided into two categories. The first is the cost for investments and the second is the cost for all other plan services. The cost of the investments should then be reduced by any revenue sharing that is used to subsidize the other services (*e.g.*, recordkeeping, compliance, participant-level investment education, and so on). Correspondingly, the cost of those services should be viewed as being increased by the amount of the revenue sharing – in order to get a true picture of the properly allocated cost. In going through that process, plan sponsors will learn about the true cost of the investments, the true cost of services, and the nature and amount of revenue sharing. By doing that, the plan sponsor, in its fiduciary capacity, will have gone a long way towards satisfying the law. That is, it will have conducted a prudent investigation into the cost and will have understood the cost.

The only remaining question is whether the costs and compensation continue to be competitive. So, every three or four years, it would be a best practice for plan sponsors to confirm their understanding that the investments and services in their plan are competitive.

[79] *Tussey v. ABB, Inc.*, 2:06-CV-04305-NKL, 2012 WL *1113291* (W.D. Mo. Mar. 31, 2012) amended in part, 06-4305-CV-C-NKL, 2012 WL *2368471* (W.D. Mo. June 21, 2012) reconsideration denied,2:06-CV-04305-NKL, 2012 WL *5512389*(W.D. Mo. Nov. 14, 2012) and aff'd in part, vacated in part, rev'd in part, 746 F.3d 327 (8th Cir. 2014).

[80] DOL Reg §2550.408b-2(c).

FAILURE TO ENGAGE IN A PRUDENT PROCESS

The situation: The fiduciaries retain the services of a consultant to help them select the investments for the company's 401(k) plan. The fiduciaries "rubber stamp" the consultant's recommendations, that is, the fiduciaries do not carefully review and understand the consultant's report and advice.[81]

The investments selected by the consultant perform poorly and, as a result, the participants suffer losses. The participants ultimately sue, alleging that the plan's investments were inferior and overly expensive and that the plan fiduciaries failed to act prudently in selecting those investments.

The rule: The key to fulfilling a fiduciary's obligations is the prudence requirement. Although courts will look favorably on fiduciaries that use advisers, they cannot rely blindly on the consultant's advice.[82] Fiduciaries must review, evaluate and understand the advice and then decide whether to accept it.

Consequences: The failure to engage in a prudent process is a breach of fiduciary duty. Once there is a breach, the fiduciary is liable for any resulting damages.

[81] See, *In re Unisys Savings Plan Litigation*, 74 F.3d 420 (3d Cir. 1996).
[82] As stated in *Martin v. Feilen*, 965 F.2d 660, 671 (8th Cir. 1992) "courts should look closely at whether the fiduciaries investigated alternative actions and relied on outside advisors before implementing a challenged transaction." See, also, *Bisceglia v. Bisceglia*, 17 F.3d 393 (9th Cir. 1994) "Although reliance on an adviser will not immunize a trustee's [or other fiduciary's] actions, it is a factor to be weighed in determining whether a trustee breached his or her duty.

Examples of Fiduciary Violations

PRACTICAL TIP

The key to showing compliance is to show that each committee member read the report presented by the investment adviser. So, it is advisable for the committee members to receive the investment adviser's report a week or two before the committee meeting, to ensure that they have a reasonable amount of time to review it.

Then the committee members should get together and meet with the investment adviser present. The committee members should have the investment adviser go through the report, with particular focus on any concerns that the adviser or committee members may have and with particular focus on any recommendations being made by the adviser. When the adviser is going through the report, the committee members should, as a best practice, ask any questions that they have. In particular, if there is anything that they don't understand, they need to make the adviser explain it. If it cannot be explained at that point, then the committee member should ask the adviser to put together additional information and follow up on that request.

Examples of Fiduciary Violations

FAILURE TO PARTICIPATE IN THE PROCESS – INACTION OF COMMITTEE MEMBERS

The situation: A large national company appoints its president to the plan committee. The committee meets quarterly. The president's job responsibilities take up the majority of his time and he is unable to attend any of the meetings over several years. Despite his absence from the meetings, the president remains on the committee.

The rule: As a member of the committee, the president is a fiduciary of the plan. ERISA requires that fiduciaries, such as the committee members who make decisions about the plan, engage in a prudent process to manage and monitor the plan.[83]

Consequences: The president's failure to fulfill his responsibility as a committee member is a potential breach of fiduciary duty. In addition, since the other members of the committee attending those meetings were aware of his breach and did nothing to remedy it, it could be argued that those members committed a breach of their fiduciary duty. Fortunately, there was no negative impact on the plan (*i.e.*, the plan did not suffer any losses as a result of the breach). However, if there had been losses as a result of the president's failure to participate, the president and the other members of the committee could possibly have been jointly and severally liable.

[83] ERISA § 404(a)(1).

Examples of Fiduciary Violations

PRACTICAL TIP

In almost all cases, it is the Board of Directors responsibility to select the committee members. Typically, though, the President would make a recommendation to the Board about who should be on the committee.

In selecting the plan committee, the Board should focus on appointing responsible officers, that is, officers who are interested in the issues related to employee benefits and who have the time to devote to the subject – as well as possibly having any critical skills that would be helpful in the administrative tasks or investment of an employee benefit program.

Typically, the plan committee members for a large company include the Vice President of Human Resources (who is often the chairperson), the CFO (or a representative of the CFO), possible one or two other finance or benefits officials, and perhaps somebody from the General Counsel's office. Usually, plan committees are three to five members. As a best practice, the plan committee should give an annual report to the Board of Directors, which includes, among other things, the meetings that the committee held and who was present at or absent from those meetings.

CUNA Mutual Group Can Help

The first step in managing your fiduciary responsibility is to recognize your needs and then to assess the plan features and services that are needed to properly operate your plan and to prudently fulfill your duties. CUNA Mutual Group offers a wide-array of plan design features, products and services to help you along the way.

In every section of this guidebook, there is a “How Can CUNA Mutual Group Help” link. The link offers plan features, products and services including education for administrators and participants.

Below are ways CUNA Mutual Group can help you listed by topic:

Understanding My Fiduciary Responsibilities

Using Investment Policy Statements When Investing Plan Money

Understanding My Liability

Compliance Guidelines

Avoiding Prohibited Transactions

Educating Our Employees

Examples of Fiduciary Violations