

Tips for Plan Sponsors

An effective retirement plan committee is a vital weapon in your fiduciary defense system.

The Essential Elements of an Effective Retirement Plan Committee

September 22, 2008
Dallas, Texas

Harness the Power of an Investment Committee

The current legal atmosphere demands action in order to ensure that your plan's investment program is sound and efficient. A well managed investment committee is vital for the safety of plan officials.

Effective committees have prudent processes for...

- *selecting members;*
- *training members;*
- *committee governance;*
- *use of consultants; and*
- *certification of practices.*

Federal law imposes a tough standard on plan officials. It requires them to prudently select and monitor investment firms, recordkeepers, and other service providers. It is also federal law that investment options be selected and monitored prudently.

An effective investment committee is a fiduciary's best defense against charges that he or she failed to perform their duty.

Why Retirement Plan Committees are Needed

The heaviest civil legal liability in the U.S. falls on "fiduciaries", and for good reason. Fiduciaries oversee the handling of other peoples' money. Accordingly, fiduciaries occupy a sacred position of trust. They are in effect, **Investment Stewards**. Just as in the U.S., cultures all over the world recognize stewardship as a human duty that outranks all others.

Retirement plan sponsors are fiduciaries. The employees that plan sponsors appoint as officials to manage their plans are also fiduciaries. In order to prove that plan officials fulfill the duties required of fiduciaries, pension and trust laws insist that they adhere to a "prudent process." (The prudent process substantiated by such laws is defined in the 22 practices for Investment Stewards published in the *Global Fiduciary Standard of Excellence (the "Standard").*)

A needed first step in meeting prudence rules is to form a retirement plan committee that enforces best practices for a plan's Investment Stewards. Many plan sponsors name their stewardship group an investment committee. Combined with proper ongoing governance, such a committee forms an effective barrier against the legal risks to which plan officials are exposed.

Investment committees allow fiduciaries to collaborate on decisions, evaluate service providers, and demonstrate a formal orderly approach to overseeing other peoples' money. While such formality may seem mundane, it is the only method by which fiduciaries can prove a proper focus on the processes by which the Department of Labor and the courts test the conduct of plan officials.

It comes as a surprise to many plan officials that their legal duty is not to achieve the highest rate of return on their plan's investments. Instead, proof of their competency as fiduciaries is found in the quality of the process they use to oversee their plans.

Forming and maintaining an investment committee is in and of itself an act of prudence. Qualifying the committee's actions ongoing as prudent, however, requires knowledge of the **Standard**. Consequently, getting trained by an independent source that has the needed expertise is a necessity for new and existing investment committees alike. (TIP: Use a firm that certifies plan sponsors against the **Standard**.)

Safety in the Face of Catastrophe

Events of recent weeks brought the U.S. to the brink of a financial catastrophe. While the Congress deliberates on how to prevent the U.S. from going over the edge, the investment markets whipsaw 401(k) account values at a dizzying pace.

The current atmosphere is toxic for plan officials. When the inevitable challenge to their approach to investment oversight emerges, many will fail the test. Lawyers representing plan participants and agents from the Department of Labor will want proof that plan officials adhere to the practices embedded in the **Standard**. Fiduciaries who serve on certified investment committees will be best prepared to handle the onslaught. It is imperative that you upgrade your fiduciary practices and have them certified against the **Standard**.

Where to Begin

As it has often been said, *timing in life is everything* – this could not be a better time for plan sponsors to take stock of how well they adhere to the fiduciary **Standard**. It starts with a full review of your investment committee's fiduciary *process*. The benchmark for the review must be the **Standard**. No other measuring stick exists that will show you the omissions that get so many plan sponsors in trouble and how to fix them.

The **Standard** was developed independently of investment firms and other service providers. The result is an unbiased independent set of steps that plan officials can use with confidence. The **Standard** is substantiated by court cases, industry best practices, and the following major pension and trust laws:

- ERISA – Employee Retirement Income Act (*Retirement Plans*)
- UPIA – Uniform Prudent Investors Act (*Trusts and Trustees*)
- UPMIFA – Uniform Prudent Management of Institutional Funds Act (*Endowments and Foundations*)
- MPERS - Management of Public Employee Retirement Systems Act (*Public Pensions*).

If you use a consultant to conduct the review, be sure it is not a firm that provides investment products or investment advice. Use only a firm that specializes in fiduciary practices and certifications. The danger in using a firm that offers investment products and investing advice is that the results of the review will be useless in court. Although valuable for guiding plan officials' investment choices, investment providers have an inherent and incurable conflict of interest with plan sponsors. Consequently, when the subject is fiduciary process, an investment provider's advice is not independent. In other words, "do not buy your chicken wire from the fox", especially now.

The results of the fiduciary review should provide a road map for improving your investment committee's quality management system. Among other things, it will help plan officials obtain the safety intended for them by testing the effectiveness of "safe harbor" provisions. It will also answer questions about the reasonableness of fees paid to their plan's service providers and uncover dangerous conflicts of interest that may exist.

Plan Sponsor Certification – A Powerful Way to Improve Your Fiduciary Excellence

The global business community began adopting ISO standards in 1947. The purpose of ISO's 17,000 standards, such as ISO 9000, is to ensure the integrity of quality management systems among manufacturing, distribution, finance, and technology firms. The **Standard** follows the ISO pattern. It is the only way for investment committees to show by an independent test that their members adhere to ERISA's prudent process. Certification also builds a foundation for continued process improvements.

In light of the importance that plan officials follow a prudent process, investment committees should get their practices certified against the **Standard**. The Department of Labor agrees. As one enforcement officer said; "With all the turmoil in the financial markets, plan officials are in a teachable moment."

Principles for Investment Committee Conduct

Whether you are setting up an investment committee for the first time or upgrading an existing committee, an orientation program that describes members' duties, controls, practices, and service provider monitoring is vital. Reasons for this include the Department of Labor's new regulation 408(b)(2) coming in 2009. Legal experts warn that the regulation will reshape the 401(k) world.

An investment committee's governance guidelines should be constructed around the basic responsibilities of plan officials under ERISA. They include four major principles:

Duty of Loyalty – ERISA requires fiduciaries to make decisions based solely on the best interests of plan participants. The Duty of Loyalty is violated in many, varied, and often unintended ways. ERISA makes no provision, however, for intent. Acts of omission are as much a violation as acts of commission.

Duty to Diversify – ERISA requires plan officials to offer a diversified investment menu that allows participants to minimize risk of long-term losses. Absent independent certification that they followed the right steps, fiduciaries find it difficult to prove that they evaluate such risk. While most retirement plans offer diversified options for employees, many fiduciaries simply accept an investment firm's menu without understanding the embedded risks. The result, plaintiff lawyers are having a heyday!

Duty to Incur Only Reasonable Expenses – The Department of Labor concluded recently that few plan officials use a formal process to compare the costs of services that their participants' actually receive against the market for such services. Yet ERISA requires fiduciaries to ensure the reasonableness of plan expenses. Lawyers for plan participants also find that fiduciaries are vulnerable on this issue.

Duty to Avoid Prohibited Transactions – Plan officials are required by ERISA to safeguard against activities that constitute conflicts of interest, payment of direct or indirect fees to parties in interest, and to ensure that they are aware of their plans' service providers' sources of income. Regulation 408(b)(2) mentioned above will require fiduciary practices that trigger an alert to its prohibited transaction set-up.

Every sponsor of an ERISA retirement plan should adopt the investment process defined in the **Standard**. It exceeds ERISA's requirements. Organizations that adopt the **Standard**, and get certified against it, greatly improve protection for their plan's officials. Participants in their plans receive major benefits, too. Not the least of which is better net returns over the long-term. A key element in conforming to the **Standard** is the formation and effective governance of an investment committee. If your organization does not have an investment committee, start one without delay.

In Summary

Be sure to establish your investment committee on the **Standard**. Obtain training and a review of your committee's practices from a firm that specializes in certifications of plan sponsors. Then, get certified. You may learn more about certifications and committee practices by calling **Roland|Criss at 800-440-3457**.

Roland|Criss is the nation's leading provider of risk management solutions to retirement plan sponsors. Roland|Criss is also the manager of certification assessments of investment advisors, investment managers, and recordkeepers for CEFEX and ASPPA. Roland|Criss does not sell investment products or manage retirement plan assets. It does not offer recordkeeping, administration, or custodian services to pension plans. It specializes in assessments and certifications of plan sponsors and service providers' practices against a defined standard of excellence.

Roland|Criss
(800) 440-3457
www.rolandcriss.com

Roland|Criss authored the information contained in this briefing. Its focus is on issues facing executives who serve defined contribution and defined benefit plans. It was released as a complimentary service. While Roland|Criss evaluated the material contained in this briefing for its interest to our readers, it does not endorse, and hereby disclaims, any and all responsibility or liability for the applicability to a reader's situation, completeness, or legality of the material. The reader should rely on this material only after an independent review of its completeness, accuracy, and timeliness. The publisher of the content has copyrighted this material.