State of Wisconsin

Navigating the Changing Fiduciary Landscape

Marilyn R. Collister
Senior Director, Legislative and Regulatory Affairs

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Discussion Topics

- The Changing Fiduciary Landscape
- What is Fiduciary Capacity
- Employer vs. Fiduciary Responsibility
- Identifying Your Plan Fiduciaries
- Fiduciary Standards of Conduct
- Fiduciary Functions
- Participant Lawsuits
- Reducing Potential Fiduciary Liability

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The Changing Fiduciary Landscape

- DC plans are one of the fastest-growing segments of the retirement industry.
- Healthcare and retirement plans result in the largest tax expenditures, thus:
  - Legislators may look to reduce plan contributions to increase tax revenues.
  - IRS and DOL scrutiny and regulation of plans will continue as regulators seek to promote retirement security.
- Plan participants have heightened awareness of the importance of their retirement needs and plan investments and fees and are suing their plan sponsors.
- Changing landscape is forcing plan sponsors to make changes based upon:
  - Lessons learned from court decisions.
  - Increased oversight by the IRS.
  - Increased pressure for fee transparency due to DOL's fee disclosure regulations.
  - Increased emphasis on retirement readiness.

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What is Fiduciary Capacity

- This question gets right at the heart of what constitutes fiduciary capacity and when it attaches to an individual.
- A person acts in a fiduciary capacity when he or she handles money or property for the benefit of another – here, the plan sponsor handles money for the benefit of plan participants.
- It is precisely because plan assets do not belong to the employer, but rather are held in trust for plan participants, that the plan sponsor has fiduciary responsibility.
- Fiduciary responsibility arises every time the plan sponsor, or certain designated employees, make decisions that impact the plan and plan assets.
- Fiduciaries are held to the highest standards under the law so it is important to identify your plan fiduciaries and know when you are acting as a fiduciary rather than as an employer.

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Employer versus Fiduciary Responsibility

- Offering a retirement plan involves both employer and fiduciary functions.
- Employer responsibilities include determining the benefit package:
  - Deciding whether to offer a 457(b) plan, or other benefits, to employees,
  - Establishing the plan,
  - Designing the plan's benefits and features,
  - Determining who is eligible to participate,
  - Amending the plan to add or remove optional provisions, such as loans or Roth accounts, or
  - Terminating the plan.

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Fiduciary versus Employer Responsibility

- Fiduciaries are charged with implementing the employer's decisions.
- Fiduciary responsibilities to the plan and its participants include:
  - Keeping the plan documents updated,
  - Administering the plan in compliance with the plan documents,
  - Selecting, monitoring and changing investment options,
  - Selecting, monitoring and changing service providers,
  - Establishing policies and procedures for the plan, and
  - Ensuring all fees are reasonable.

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Identifying Plan Fiduciaries

- Fiduciary status is based on functions performed, not a person's title.
- Anyone who has the discretion to manage or administer the plan or exercise control over plan assets is a fiduciary.
- A plan's fiduciaries include the plan sponsor as well as:
  - Trustees,
  - Investment advisors,
  - Members of the plan's administrative committee, and
  - Members of the plan's investment committee.
- Staff members may be fiduciaries if they exercise discretion, such as interpreting the plan document.
- Employees not realizing they are fiduciaries or who don't know the basic rules may inadvertently breach their fiduciary responsibility.

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Third Parties Retained by the Plan

- Plan sponsors must not the make mistake of thinking that selecting third parties to assist with the plan relieves them of their fiduciary liability.
- Third parties are typically *not* fiduciaries.
- Non-fiduciary experts provide information or act on instructions from plan sponsors or participants and include:
  - Accountants,
  - Actuaries,
  - Attorneys,
  - Auditors, and
  - Recordkeepers and other service providers.
- Advisors and consultants who provide investment advice for a fee will be fiduciaries.

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Fiduciary Responsibility under Applicable Law

- SBJPA imposed exclusive benefit rule and prudence requirements on 457(b) plans.
- Code § 457(g) requires all plan assets be held in trust as of January 1, 1999.
- Fiduciary duty is imposed by the Uniform Trust Act and Uniform Prudent Investor Act:
  - Wisconsin Stat. § 881.01 - Investment; prudent person rule.
  - 881.015 Investment companies, investment trusts and collective investment vehicles.
  - 881.016 Employees and agents of a fiduciary.
  - 881.02 Construction; court orders; written instruments.
  - 881.03 Jurisdiction of court.
  - 881.04 Investments under prior laws not affected.
  - 881.05 Retention of securities by trustees.
  - 881.06 Law governing existing instruments.
- Failure to meet fiduciary obligations can result in severe penalties, including personal liability in some states.

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Fiduciary Standards of Conduct

- State laws, like the Uniform Prudent Investor Act, often mirror or are very similar to ERISA, and that is true in Wisconsin.
- Most governmental plans also use Employee Retirement Income Security Act of 1974 (ERISA) rules as a guide and best practice.
- Basic ERISA fiduciary principles found in Wisconsin Statutes include:
  - Duty of loyalty- A trustee shall invest and manage the trust assets solely in the interest of the beneficiaries.
  - Duty of prudence,
  - Duty to diversify plan assets,
  - Duty to ensure fees are reasonable,
  - Duty to monitor funds and providers and make changes when warranted, and
  - Duty to follow terms of plan documents.

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Duty of Loyalty – Avoid Conflicts of Interest

- The duty of loyalty is known as the exclusive benefit rule.
- Plan fiduciaries must act solely in the best interests of the plan participants and for the exclusive purpose of providing plan benefits.
- Fiduciaries cannot put employer interests before those of plan participants.
- Avoid conflicts of interest at all cost.
- Once fiduciaries understand the duty of loyalty to the plan, all the rest is common sense.

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Duty of Prudence

- The duty of prudence focuses on the process followed when making fiduciary decisions.
- Prudence is one of most important duties because it comes into play in every activity undertaken by the fiduciaries.
- Prudence is more than just an obligation to be competent and careful in your conduct – it requires a careful, diligent, thorough decision-making process.
- Prudence requires fiduciaries to act with the care, prudence, skill and diligence a knowledgeable person administering a retirement plan would use.
- Prudence requires the use of good judgment and sound processes when handling the affairs of the plan.

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Duty to Diversify Investment Menu

- Law requires fiduciaries to diversify unless it is clearly imprudent to do so.
- The duty to diversify is found in state law as well as ERISA.
- Plan fiduciaries are charged with selecting a mixture of funds to offer plan participants that provide:
  - A broad, diversified array of investments with different levels of risk and returns.
  - Select funds designed to provide participants with a reasonable opportunity to materially affect the potential return and degree of risk in their accounts.

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Duty to Ensure Plan Fees are Reasonable

- Duty of Loyalty requires fiduciaries to ensure plan fees and expenses are "reasonable."

- First, fiduciaries must know what fees are being charged to the plan and participants by each investment option and each service provider.

- Fiduciary's job is not to find the lowest cost fund or provider – but rather to:
  - Follow the criteria in the IPS when selecting and deselecting funds, and
  - Benchmark the quality of each provider's services and level of fees to plans of similar size and complexity.

- The DOL fee disclosure documents from your service provider can help determine the reasonableness of fees.

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Duty to Monitor Investments

- State law requires, and courts have agreed - Fiduciaries must adopt prudent investment policies and use reasonable diligence when selecting a diverse array of funds and must continually monitor them and replace ones that underperform.
- Unanimous decision of US Supreme Court in Tibble vs. Edison – May 18, 2015: Plan fiduciaries:
  - Have a continuing duty, separate and apart from the duty to exercise prudence when selecting investments, to monitor them and remove imprudent ones.
  - Must systematically consider all the plan's investments at regular intervals to ensure that they are appropriate.
  - Are under a duty to dispose of inappropriate investments within a reasonable time.
- Lessons:
  - The role of a fiduciary is active, not passive,
  - Fiduciaries have a duty to adopt and follow an Investment Policy Statement (IPS), and replace funds pursuant to that IPS.

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Investment Policy Statement (IPS)

- Prudent investment policy = adopting and following an IPS for plan investments.
- An IPS is a written governing plan document and should:
  - Outline the process for making prudent investment-related decisions.
  - Define duties and responsibilities of all parties involved in investment selection process.
- IPS defines criteria and processes for investment decisions and should set out the:
  - Methodology/criteria for selecting a broad, diversified array of investments with different levels of risk and returns.
  - Goals, objectives and performance standards the funds are expected to meet to be retained in the investment menu.
  - Guidelines for monitoring and evaluating funds, and timing for terminating and replacing any nonperforming funds.
- IPS should require regular meeting schedule for evaluating the current investment menu and initiating changes when necessary.

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Duty to Monitor Third Parties

- Develop a prudent formal process for selecting and monitoring third parties.
- Use objective criteria in the selection process:
  - Financial condition,
  - Experience,
  - Quality of the services,
  - Any recent litigation or enforcement action, and
  - The proposed fee structure.
- Determine that:
  - Fees paid with plan assets to a third party are reasonable.
  - Third party has no conflicts of interest that could influence his or her recommendations to your plan.
- Document your review process and the basis for your hiring and firing decisions.

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Duty to Follow Plan Documents

- Plan administration is as important as investment selection!
- Plan document is your contract with plan participants and must:
  - Comply in form to the Internal Revenue Code,
  - Include all required provisions set out in the Code and regulations, and
  - Describe each optional feature you are offering participants.
- Read the plan document thoroughly and often and be sure you understand how every provision is to operate.
- The plan document is your manual for administering the plan.
  - Compare plan policies, procedures and forms to the terms of the document.
  - Revise any procedures that do not exactly match the document.
- Failure to operate the plan in compliance with governing documents is a top IRS audit “catch-all” and can cause the plan to become ineligible.

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Fiduciary Administrative Responsibilities

- Plan fiduciaries don't always realize scope of their fiduciary responsibilities:
  - Identifying and training the plan fiduciaries.
  - Designing and implementing the plan.
  - Establishing policies and procedures for the plan.
  - Administering and operating the plan.
  - Keeping the plan document updated for all law changes.
  - Selecting and monitoring plan's investment options pursuant to a written Investment Policy Statement (IPS)
  - Making investment changes where warranted.
  - Selecting and monitoring trustees, service providers, consultants and others.
  - Ensuring the investment and service provider fees are reasonable.
  - Maintaining documentation of all plan-related decisions.
  - Repeat.
- Can be more than twice the work with multiple recordkeepers.

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Participant Allegations Against Plan Fiduciaries

- Recent 401(k) plan participant lawsuits against plan sponsors are very instructional.
- Actions that prompted these lawsuits are not unique to companies being sued:
  - Most of the cases are NOT the result of fraudulent activity.
  - Many other plan sponsors are "guilty" of the same actions (or inactions).
- At issue: whether plan fiduciaries breached their duty when they:
  - Selected expensive share classes when less expensive share classes were available,
  - Failed to prudently monitor and ensure only reasonable fees are paid for recordkeeping costs and investment options, and
  - Making changes where warranted.
- Lawsuits show us why it is so important to know who is a plan fiduciary and what basic standards of conduct apply.
- Lawsuits focus on the duty to act solely in the best interest of plan participants - most cases boil down to the fact that the retirement plan committees lacked a disciplined process for administering the plan.

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Large University 403(b) Plans Targeted

- More than a dozen jumbo university plans sued by participants in August 2016.
- New charges could also apply to 457(b) plans with multiple recordkeepers:
  - Allowing unreasonable expenses to be charged for plan administration, and
  - Retaining high cost and poor-performing investments compared to available alternatives.
- Sponsors charged with not acting in best interest of participants when, among other things, they allowed their plans to:
  - Use multiple recordkeepers on the plan;
  - Include too many investment choices in the plan leading to "decision paralysis" and higher than reasonable fees;
  - Offer duplicative investments "in every major asset class and investment style";
  - Pay asset-based recordkeeping fees rather than a per participant charge; and
  - Offer funds with high fees and/or restrictions.

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Lessons Learned from Lawsuits

- Court decisions turn on fiduciary prudence and operating the plan in compliance with plan documents, including the IPS.
- Fiduciary prudence is process driven not outcome driven.
- Fiduciaries have a continuing duty, separate and apart from the duty to exercise prudence in selecting investments, to monitor and remove imprudent investments.
- Adopt best practices for fulfilling each of your fiduciary duties to monitor investments, service providers and fees.
- Key: The role of a fiduciary is active, not passive - fiduciary success depends upon:
  - Basing every plan decision on what is best for your plan participants,
  - Complying with your governing documents, and
  - Making changes when warranted.

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Plan's Committee - Best Practices are Key

- Properly structure the plan's committee and their activities:
  - Select qualified, committed people.
  - Select individuals with sufficient time to devote to prudent oversight of plan administration, investment options, operation and service provider(s).
  - Put regularly scheduled meetings on the calendar.
- Train plan fiduciaries:
  - Educate fiduciaries on their basic fiduciary duties.
  - Be sure fiduciaries understand they are the ones responsible for properly administering the plan, not the trustee or service provider or consultants.
- A sound fiduciary governance process:
  - Enhances the participant experience, and
  - Reduces liability of employer, Board or Committee members and other fiduciaries.
- Document decisions as well as the prudent, deliberative process that was followed in making all plan-related decisions.

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Hold Regularly Scheduled Meetings

- Hold committee meetings regularly to discuss and make decisions for the plan.
- Include all plan fiduciaries and any staff or third parties needing to provide information to the committee.
- Key things to document in meeting minutes include:
  - Identity of all persons in attendance.
  - Prominently highlight the prudent process followed at the meeting.
  - Focus on decisions reached at the meeting.
  - Incorporate reports from third-party advisers by reference and maintain as part of the minutes.
  - Emphasize advice provided by third-party advisers and legal counsel.
- Draft the minutes timely and ask all attendees to approve them.

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Fiduciary File Cabinet

- Plan fiduciaries must document systematic processes and evidence that good processes were followed.
- Keep signed documents in a safe, accessible place:
  - Plan documents and any summary plan materials,
  - Trust agreement,
  - Plan forms, rules and procedures,
  - Service agreements,
  - Third party contracts,
  - Investment contracts,
  - Investment Policy Statement,
  - All amendments to those documents, and
  - Committee meeting minutes.

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Reduce Your Fiduciary Oversight and Potential Liability

- A single recordkeeper simplifies fiduciary oversight and reduces fiduciary liability.
- It eliminates higher fees due to a smaller number of participants paying for duplicative recordkeeping services.
- It simplifies plan design and significantly reduces the time and effort needed to fulfill your fiduciary responsibilities with respect to prudently:
  - Selecting, monitoring and deselecting funds,
  - Agreements and complying with the terms of your plan document,
  - Monitoring multiple recordkeepers to ensure that each one is satisfying the terms of their services, and the fees charged by each of your providers, to ensure they are reasonable and in the best interest of participants.
- Lower fees have been proven to:
  - Dramatically increase participant account balances over time.
  - Improve participant retirement readiness.

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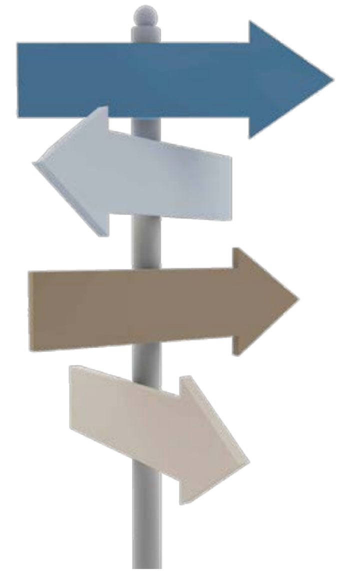
Enhance the Participant Experience

- One recordkeeper simplifies a participant's decision to participate in the plan by eliminating the initial hurdle of which vender to choose.
- Employees already have to decide:
  - Whether to enroll?
  - How much to save?
  - Which investments to select?
- One recordkeeper allows fiduciaries to focus participant communications on plan features and benefits, not sales material from vendors.
- Ongoing education programs using various mediums can be streamlined.
- Providing ERISA 404(c) information to participants is an important part of fulfilling fiduciary responsibility.



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Communicating to Plan Participants - 404(c)

- Plan fiduciaries can avoid liability for individual participant investment decisions by following the principles in ERISA 404(c):
  - Offer a broad range of investments - at least three options with different risk and return characteristics,
  - Select funds designed to provide participants with a reasonable opportunity to materially affect the potential return and degree of risk in their own accounts.
- Develop easy to understand communications to educate employees about key plan features and how participating in the plan would benefit them.
- Assist participants to become informed investors by informing them of:
  - Their right to direct their own investments in the plan,
  - How to make and change investment decisions,
  - The funds and fund managers available under the plan,
  - Investment related fees,
  - Any restrictions on investment transfers, and
  - The name of who to contact for more information.

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Complying with 404(c)

- Communication materials prepared by you/Empower are helpful in complying with the disclosure requirements contained in ERISA 404(c):
- These materials include, among a number of others:
  - Investment Options at a Glance
  - Fund data sheets
  - Plan Features and Highlights
  - Quarterly newsletters enclosed with the participant statements
  - Brochures, articles and any videos on the website
  - Special mailings such as employer newsletters, and
  - Seminars to assist with employee education.

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Summary

- Plan sponsors are plan fiduciaries.
- The ultimate responsibility for the plan and its operations cannot be outsourced or relinquished.
- Act solely in the best interests of participants.
- Document your prudent decision-making.
- Keep good records.
- The key is being knowledgeable and acting sensibly when making plan decisions.

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Thank you!
Questions?