



2011 ISSUE BROCHURE

PLAN SPONSORS: MEETING YOUR FIDUCIARY RESPONSIBILITIES

By: NAGDCA Publications Committee and Executive Board

Introduction

Maintaining a healthy retirement savings plan requires some time and effort on the part of the Plan Sponsor. This has become even more apparent since the recent economic downturn and volatility in the markets have put fiduciary issues in the spotlight. Compliance may not, however, be as difficult as you might imagine. Your plan participants are counting on you to maintain a retirement plan designed to help them save for retirement. Are you up to the challenge?

NAGDCA has created this brochure to provide you, a fiduciary of a participant directed defined contribution plan, with general information that you may find helpful in complying with your fiduciary responsibilities. Although governmental employers are not subject to Employee Retirement Income Security Act of 1974 (ERISA), many states have fiduciary statutes that are similar to ERISA, and the ERISA principles provide a good guide for fiduciary prudence in any event. This brochure provides a simplified explanation of basic fiduciary responsibility. It is not a legal interpretation of your responsibilities under state or applicable law, nor is it intended to be a substitute for the advice of a retirement plan professional.

Who is a Plan Fiduciary?

Plan fiduciaries include:

- Any person specifically named as a fiduciary in the plan document. This may include the plan administrator, the plan board members, an administrative committee or plan trustees;
- Any person with discretionary control over the administration of the plan, which would include the board, committee or other plan administrator;
- Any person with discretionary control over the investment of plan assets; and
- Any person rendering investment advice with respect to the plan's investment options for a fee or other compensation.

Thus, a plan sponsor is always considered a plan fiduciary by virtue of maintaining and administering the plan. Although a person may be a fiduciary only with respect to the areas of plan operation over which they exercise discretionary authority, the plan sponsor typically fulfills a variety of roles with respect to plan operation. A person may also exercise fiduciary authority when selecting and monitoring the investment options offered under the plan and the providers retained to provide services to the plan.

Significance of Being a Fiduciary

As a plan fiduciary, you must perform your duties prudently and in the best interest of plan participants and beneficiaries. The principles plan fiduciaries are expected to follow include:

- Acting solely in the interest of plan participants and their beneficiaries and with the exclusive purpose of providing benefits to them;
- Carrying out fiduciary duties prudently;
- Following properly drafted plan documents;
- Diversifying plan investments; and
- Paying only reasonable plan expenses.

A Plan Fiduciary's Roles

Several functions associated with administering a defined contribution 457(b), 401(k), 401(a), or 403(b) plan are fiduciary functions and it is important that each person performing one or more of the following functions understands his or her role(s) and responsibilities:

- **Plan Oversight** - keeping the plan document up to date and developing rules and procedures for operating the plan, such as the criteria for eligibility,

contributions and distributions; monitoring participation rates, surveying employee satisfaction.

- **Plan Administration** – implementing the terms of the plan in accordance with the rules and procedures adopted. This may include such functions as preparing communications materials, disclosing fees, reviewing and authorizing unforeseeable emergency withdrawals, reviewing qualified domestic relations orders, authorizing participant loans.
- **Investment Committee** - selecting the menu of investment options to be offered under the plan and then monitoring those investments and deselecting any investment that does not continue to meet the criteria set forth in the plan's investment policy statement.
- **Service Provider Selection Committee** – selecting trustees, custodians, recordkeepers, consultants, attorneys, advisers, auditors or other experts required to effectively administer the plan and then monitoring their performance.



A Plan Fiduciary's Responsibilities

Exclusive Benefit Rule - One of the most important fiduciary duties is the requirement to act solely in the best interest of plan participants and their beneficiaries. All plan decisions are to be made exclusively in the best interest of plan participants and beneficiaries and specifically free from conflicts of interest from your employer or other third-parties, such as providers, auditors or consultants.

Prudent Person Rule - The ERISA prudence standard is one of the highest known to the law and focuses on the process for making informed and reasoned fiduciary decisions. As a fiduciary, you are required to act with the care, prudence, skill and diligence that a knowledgeable person would use in administering a defined contribution plan. This requires you to carry out your duties in accordance with good judgment and sound processes.

Three key ingredients of the prudence process are (1) the duty to investigate; (2) the duty to maintain records; and (3) the duty to obtain expert assistance where necessary. Thus, keeping minutes of committee and/or board meetings to document your decisions and the basis for those decisions, and retaining professionals such as trustees, attorneys, accountants, consultants and/or investment managers when required to ensure expertise is critical.

Compliance with the Plan Document

- The plan document is the contract between the plan sponsor and the plan participants and beneficiaries. The plan document is your manual for operating and administering the plan. You must keep the plan document updated to comply with the Internal Revenue Code and ensure that you

are operating and administering the plan in accordance with the document. All rules and procedures adopted for administering the plan must conform to the terms of the plan document.

Diversify the Menu of Investment

Options Offered Under the Plan – The prudent person standard requires plan fiduciaries to offer a diverse range of investment options to plan participants. Diversification may be accomplished by offering a core menu of investment options with materially different risk and return characteristics and investment objectives, consisting of any combination of the following: mutual funds, separate account portfolios, fund of funds (e.g., target date and/or risk based funds) and whether a self-directed brokerage option is available in addition to the core investment options. Consideration of investment principles, existing options and employee demographics (age, salary, tenure) may assist fiduciaries in establishing criteria for the selection of investment choices for the plan.

Plan fiduciaries are well served by adopting a written investment policy statement (IPS) setting forth the goals and objectives of the investment options to be selected. An effective IPS also contains the guidelines for monitoring and evaluating the plan's investment options periodically, and includes procedures for terminating and replacing any under-performing fund. Determining the level of investment advice and education to be offered to participants is also a fiduciary function. Many employers are offering participants advice and guidance to assist them in making informed investment decisions. You may decide to retain a fiduciary investment adviser offering specific investment advice to participants, or a non-fiduciary service

provider to provide general financial and investment education, interactive investment materials, and information based on asset allocation models. In either case, it is important for you to develop effective communication materials to educate participants on the options offered by the plan.

Monitor Investments and Service Providers – You must periodically monitor the menu of investment options offered to plan participants and the experts you retain to assist you. Your written IPS will be an immensely valuable tool in monitoring funds and taking necessary action. Once again, fiduciaries will want to document their evaluation and investment selection decisions. With respect to trustees or custodians, third party administrators, investment advisory services, attorneys, auditors and others you have chosen to perform services to the plan, the contract between the plan and the service provider should set out the duties to be performed.

Periodic evaluation is necessary to ensure that the service providers are performing the agreed upon duties prudently. You should establish and follow a formal review process at reasonable intervals to decide if you want to continue using the service providers or seek alternative service providers through a request for proposal (RFP) or, if permitted, a search process. When monitoring service providers, actions

to ensure they are performing agreed upon procedures include:

- Reviewing the service provider’s performance (participant surveys, report provided, etc.)
- Checking actual fees charged
- Following up on participant complaints

Develop Prudent Fiduciary Processes and Procedures – Developing a prudent process for managing and operating the plan will ensure that you are administering the plan consistently and in compliance with the plan document. It is very important for plan fiduciaries to document compliance with the plan and agreed upon processes, since such documentation will increase your chances of limiting your fiduciary liability. Always keep minutes of committee and/or board meetings as well as other discussions leading to plan decisions. Fiduciary processes and procedures should include:

- Ensuring that all employee and/or employer contributions are forwarded into the trust as soon as practicable;
- Complying with a written investment policy statement;
- Handling plan loans, unforeseeable emergencies, qualified domestic relations orders and the like; and
- Developing and delivering effective, easy to understand employee communications.



ERISA AND PUBLIC EMPLOYER SPONSORED PLANS

It was stated earlier in this brochure that while governmental employers are not subject to ERISA, the ERISA principles provide a good guide for fiduciary prudence to public plan sponsors. The Department of Labor (DOL) oversees ERISA plans and recently issued final regulations expanding ERISA fiduciary responsibilities pertaining to plan fee disclosure and the dissemination of specific information. The following section is a brief overview of these new regulations. Governmental plan sponsors should familiarize themselves with this regulation. It may be considered a “best practice” and good guidance to provide to each participant or beneficiary the same the plan-related and investment-related information that ERISA plan sponsors are required to provide under these new rules.

Fee disclosure - Effective January 1, 2012, ERISA fiduciaries must disclose, on a regular and periodic basis, certain fee, expense and other investment related information. Although the DOL does not specify a permissible level of fees, it does require that fees charged to the plan and its participants are ‘reasonable’. Plan fees and expenses should be monitored through a formal review process to ensure they remain ‘reasonable’.

Plan-Related Information – There are three subcategories of plan-related information that must be given to plan participants on or before the date they can first direct their investments, and annually thereafter. ERISA plan sponsors are required to provide all the necessary information to plan participants and beneficiaries in an easy to understand

Summary Plan Description. Most governmental plans already provide easy to understand communication pieces or plan summaries to plan participants that include this information. Such materials should be reviewed in light of these regulations to ensure that all necessary information is included. The plan should also create a formal review process to ensure the accuracy of the information disclosed to participants. The three subcategories of plan-related information are:

- **General Plan Information** - General plan information consists of information about the structure and mechanics of the plan, such as an explanation of how to give investment instructions under the plan, a current list of the plan's investment options, and a description of any "brokerage windows" or similar arrangement that enables the selection of investments beyond those designated by the plan.
- **Administrative Expenses Information** - An explanation of any fees and expenses for general plan administrative services that may be charged to or deducted from all individual accounts. Examples include fees and expenses for legal, accounting, and recordkeeping services.
- **Individual Expenses Information** - An explanation of any fees and expenses that may be charged to or deducted from the individual account of a specific participant or beneficiary based on the actions taken by that person. Examples include fees for plan loans and for processing qualified domestic relations orders.

Statements of Actual Charges or Deductions

– Participants must also receive statements, at least quarterly, showing the dollar amount of the plan-related fees and expenses (whether "administrative" or "individual") actually charged to or deducted from their individual accounts, along with a description of the services for which the charge or deduction was made. If applicable, the statement must also contain an explanation that, in addition to the fees and expenses actually deducted from participant accounts, some of the plan's administrative expenses for the preceding quarter were paid from the total annual operating expenses of one or more of the plan's designated investment alternatives (e.g., through revenue sharing arrangements, Rule 12b-1 fees, sub-transfer fees).

Investment-Related Information

Investment-related information includes several subcategories of core information about each investment option under the plan. Generally, the investment-related information that must be provided includes:

- **Performance Data** - Participants must be provided specific information about historical investment performance. 1-, 5- and 10-year returns must be provided for investment options, such as mutual funds, that do not have fixed rates of return. For investment options that have a fixed or stated rate of return, the annual rate of return and the term of the investment must be disclosed.
- **Benchmark Information** - For investment options that do not have a fixed rate of return, the name and returns of an appropriate broad-based securities market index over 1-, 5-, and 10-year periods (matching the Performance Data periods) must be

provided. Investment options with fixed rates of return are not subject to this requirement.

- **Fee and Expense Information** - For investment options that do not have a fixed rate of return, the total annual operating expenses expressed as both a percentage of assets and as a dollar amount for each \$1,000 invested, and any shareholder-type fees or restrictions on the participant's ability to purchase or withdraw from the investment. For investment options that have a fixed rate of return, any shareholder-type fees or restrictions on the participant's ability to purchase or withdraw from the investment.
- **Internet Website Address** - Investment-related information includes an internet Web site address that is sufficiently specific to provide participants and beneficiaries access to specific additional information about the investment options for workers who want more or more current information.
- **Glossary** - Investment-related information includes a general glossary of terms to assist participants and beneficiaries in understanding the plan's investment options, or an Internet Web site address that is sufficiently specific to provide access to such a glossary.

Comparative Chart Format Requirement

Investment-related information must be furnished to participants or beneficiaries on or before the date they can first direct their investments, and then again annually thereafter. It also must be furnished in a chart or similar format designed to facilitate a comparison of each investment option available under the plan. The final

rule includes a model comparative chart, which when correctly completed, may be used by the plan administrator to satisfy the rule's requirement that a plan's investment option information be provided in a comparative format. After a participant has invested in a particular investment option, he or she must be provided any materials the plan receives regarding voting, tender or similar rights in the option. Upon request, the plan administrator must also furnish prospectuses, financial reports and statements of valuation and of assets held by an investment option.

Under the DOL final regulations, plan administrators will not be liable for the completeness and accuracy of information provided to participants if the plan administrator reasonably and in good faith relies upon information provided by a service provider or the issuer of an investment alternative.

Breaches of Fiduciary Duty - Fiduciary responsibilities bring potential liability. As a fiduciary, you may be personally liable to restore any losses to the plan, or to restore any profits made through improper use of the plan's assets resulting from their actions. If you are considered to be in

breach of your fiduciary duties, it may result in participant lawsuits or monetary penalties. You may be considered in breach of your fiduciary duties if you:

- Fail to comply with the exclusive benefit rule by entering into self-dealing transactions, such as using plan assets for your own or, where applicable, your company's benefit;
- Fail to exercise your responsibilities to the plan in a responsible manner;
- Fail to diversify the menu of investment options offered under the plan; or
- Fail to monitor the plan's investment options and replace funds as necessary pursuant to your investment policy.



Limiting Liability - Fiduciaries can limit their liability by demonstrating that they have carried out their responsibilities properly. As previously stated, it is very important to document the review processes and the basis for decisions made when carrying out your fiduciary responsibilities. This would include, but not be limited to, keeping minutes of committee and/or board meetings, and documenting discussions with consultants, other experts, and staff when plan matters are discussed. As an additional protection for plans, those who handle plan funds or other plan property generally may be covered by a fidelity bond. A fidelity bond is a type of insurance that protects the plan against loss resulting from fraudulent or dishonest acts of those covered by the bond.

In summary, identifying your plan fiduciaries and ensuring that they know the extent of their fiduciary duties is 9/10ths of the battle. Once you know and understand the fiduciary principles described above, compliance becomes a matter of common sense. Acting responsibly and solely in the best interests of the plan and its participants and documenting your compliance with your processes and procedures will serve you well.

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