

Fiduciary Governance for an ERISA Trustee or Why Size Doesn't Matter

Index

| | |
|---|----|
| The Overview | |
| The Problem | 2 |
| The Precedent | 2 |
| The Process | 3 |
| Duty of Loyalty | 4 |
| "[A] fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries..." | |
| - <i>USC §1104(a)(1)(A) & CFR 404a-1(B)</i> | |
| Duty to Prudently Administer | 5 |
| "[A] fiduciary shall discharge his duties with respect to a plan... with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character..." | |
| - <i>USC §1104(a)(1)(A) & CFR 401a-1</i> | |
| Duty to Pay Reasonable Fees | 6 |
| "[A] fiduciary shall discharge his duties with respect to a plan... [by] defraying reasonable expenses of administering the plan." | |
| - <i>USC §1104(a)(1)(A) & CFR 404a-5(a)</i> | |
| Duty to Balance Risk and Return | 7 |
| "[A] fiduciary shall discharge his duties with respect to a plan... [by] taking into consideration the risk of loss and the opportunity for gain associated with the investment or course of action." | |
| - <i>USC §1104(a)(1)(B) & CFR 404a-1(b)(2)(i)</i> | |
| Duty to Diversify | 8 |
| "[A] fiduciary shall discharge his duties with respect to a plan... by diversifying the investments of the plan so as to minimize the risk of large losses..." | |
| - <i>USC §1104(a)(1)(C) & CFR 404a-1(b)(2)(ii)(A)</i> | |
| The Company | 9 |
| The Services | |
| Assessment | 9 |
| Ongoing Support | 10 |

The Overview

The Problem

ERISA trustees are predominantly overworked CFOs and HR Directors who have other pressing corporate responsibilities that, frankly, make becoming an ERISA fiduciary governance expert unrealistic. Few plan trustees are familiar with their duties of care or fiduciary governance best practices.

For the most part these harried trustees want to do good for the plan beneficiaries, but they don't know where they should start. They understand that there is more to being a good ERISA trustee than attending a meeting with the plan's investment consultant who drones on about the yield curve and the funds on the "watch list." They want to know what they need to know.

The Precedent

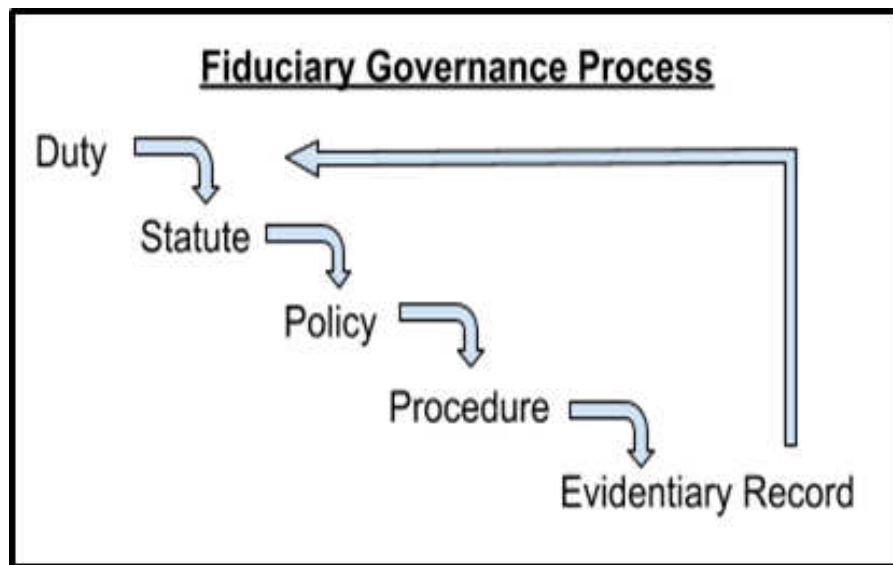
Fortunately, ERISA trustees have a long established model of excellent fiduciary governance processes to which they can look for guidance. For decades, the capital held in large public funds that administer the assets for municipal and state employees have wrestled with the question, "What does it mean to be a good trustee?" And there is a lot that can be learned from the processes these large plans have developed.

To be sure, it would be inappropriate for a ball-juggling HR Director to develop and manage a fiduciary governance process comparable to that of the California Public Employees Retirement System (CalPERS) with \$280 billion in plan assets for over 1.8 million participants. A plan committee for a 500-participant plan with \$25 million in plan assets is not expected to have the same depth of staffing, resources, or competency as a mega plan. But the trustees of both large and small plans are bound by the same duties of care, and as such, their governance processes should be similar at their core.

The size of the plan should not change the fundamental governance processes that are adopted.

The Process

Developing a governance process is central to fulfilling the trustee's duties to the plan beneficiaries. A prudent trustee will (1) identify their statutorily defined obligations, (2) adopt policies that echo these duties, and (3) execute procedures that confirm compliance with these policies. This three-step process is the framework for effective fiduciary governance for both large and small plans.



It would not be hyperbole to say that a plan trustee cannot fulfill their duties of care without developing and maintaining a comprehensive governance process, but the particular procedures which are adopted by a "big" plan are not necessarily appropriate for a "small" plan. The operational procedures that are adopted should be calibrated to, as the statute says, "an enterprise of a like character."

Following is a summary of the central fiduciary duties of care that an ERISA trustee owes to the participants they serve. Also included is a series of procedures which, if adopted and executed, demonstrates that the trustee has acted with the "care, skill, prudence and diligence" by which their activities are judged. Note, the following procedures have been uniformly adopted by "large" plans and are fundamental to fiduciary governance. These same procedures can be calibrated for smaller plans as well.

Duty of Loyalty

"[A] fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries..."

- *USC §1104(a)(1)(A) & CFR 404a-1(B)*

- Does the plan trustee have access to a short, easy-to-review summary of the ERISA fiduciary duties?
- Is there a Code of Ethics the Plan Committee has adopted, reviews, and reaffirms annually?
- Has a series of succinct policies and procedures been adopted that specifically targets each of the trustee's duties of care?
- Has a compliance calendar been developed which tracks the governance activities the Committee has directed?

Duty to Prudently Administer

"[A] fiduciary shall discharge his duties with respect to a plan... with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character..."

- *USC §1104(a)(1)(A) & CFR 401a-1*

- Has the named trustee created a record of the key duties and responsibilities they have delegated to members of the Plan Committee?
- Has an inventory been made of the vendors and/or staff that fulfill fiduciary roles to the plan, and have the vendors and/or staff acknowledged these roles?
- Have the vendors, advisors, or consultants who perform administrative functions confirmed in writing whether they are acting in a fiduciary role?
- Has the trustee taken steps to identify if any potential conflicts of interest exist between the vendors, consultants or investment managers who receive a benefit from any source other than the plan sponsor as a result of their relationship with the plan?

Duty to Pay Reasonable Fees

“[A] fiduciary shall discharge his duties with respect to a plan... [by] defraying reasonable expenses of administering the plan.”

- *USC §1104(a)(1)(A) & CFR 404a-5(a)*

- Has the Committee documented their policy on direct pay versus revenue share fees and the rationale for the fee approach they have adopted?
- Has a fee study been conducted to confirm the fees paid to vendors, advisors, consultants or managers are “reasonable” and within industry norms given the plan’s size and complexity?¹
- Do your vendors receive compensation from any third party based on the relationship they have with the plan (revenue share fees, promotional compensation, etc.)?
- Where distinct services are provided by one vendor – record keeping, investment advisory, administration, et cetera – for one bundled fee, has the trustee tested if each distinct service is appropriately priced?²

¹ Tussey v. ABB, Inc., 746 F. 3d 327 - Court of Appeals, 8th Circuit 2014

² DOL AO 2013-03A

Duty to Balance Risk and Return

"[A] fiduciary shall discharge his duties with respect to a plan... [by] taking into consideration the risk of loss and the opportunity for gain associated with the investment or course of action."

- *USC §1104(a)(1)(B) & CFR 404a-1(b)(2)(i)*

- Has an investigation been conducted to confirm that the benchmarks being used have risk/return characteristics consistent with the plan assets?
- For plan assets that are pooled, has a blended benchmark been developed to appropriately represent the risk and return characteristics of the combined plan assets?
- Has the trustee identified any risk factors to which the plan is exposed that are not statistically derived – leverage, valuation, concentration, and liquidity?
- Is there an Investment Policy Statement for the plan assets, whether self-directed or pooled?

Duty to Diversify

“[A] fiduciary shall discharge his duties with respect to a plan... by diversifying the investments of the plan so as to minimize the risk of large losses...”

- *USC §1104(a)(1)(C) & CFR 404a-1(b)(2)(ii)(A)*

- Has a study been conducted to confirm that the benchmarks being used have similar investment characteristics (market cap, growth/value tilt, duration, et cetera) of the assets being tracked.³
- Are the assets within each of the self-directed investment options reasonably diversified?⁴
- Do the self-directed investment options represent a variety of asset classes and style types to allow for a participant to be reasonably diversified?
- If there are pooled assets in the plan (PSP, DC, DB), is there a clear rebalancing policy/process that is consistently followed?⁵

“Go and do likewise.”

³ Liss v. Smith - 7 factors the trustee is to consider when diversifying.

⁴ Unisys I (3rd Cir. 1996) and GIW Indus. (11th Cir. 1990).

⁵ Marshall v. Glass/Metal (D. Haw. 1980 - "...commitment of 23% of the Pension Plan's total assets to a single loan subjects a disproportionate amount of the trust assets to the risk of a large loss."

The Company:

Anodos helps ERISA trustees audit, develop, and maintain a governance processes. Doing so helps trustees save time, reduce their personal risk and fulfill their duties of care.

We do this by conducting manager performance audits, developing governance policies and procedures, evaluating the trustee's books and records, administering vendor searches (RFPs), and engaging in special projects as directed by the trustee.

What makes us unique is that all we do is provide fiduciary governance support. We do not manage money, sell insurance, serve as a plan administrator or accept revenue from any third parties. We do not have a horse in the race.

The Services:

Some trustees prefer to have a one-time governance audit of the plan. Other trustees prefer to engage Anodos for ongoing governance support. In this type of engagement we begin by conducting a governance audit that identifies any gaps in the Committee's existing governance processes or documents.

Next, we help the Committee adopt a series of policies and procedures, a compliance library and a compliance calendar to efficiently manage these duties on an ongoing basis.

Once this governance infrastructure has been established, Anodos, in coordination with plan staff, executes the procedures on behalf of the Committee and reports our findings and recommendations at each Committee meeting.

The minimum fee for providing ongoing Fiduciary Governance Support is \$6,000 per year, but may increase based on the size and complexity of the plan.

Exhibit A - Sketchbook



