MANAGING INVESTMENT RESPONSIBILITIES:

Investment Decisions For Plan Fiduciaries

A White Paper Prepared by LIMRA and Transamerica Retirement Solutions

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Contents

By establishing a defined contribution plan, businesses provide their employees with an essential pathway to potential financial security in retirement. Although much of the responsibility for participating in the plan lies with the employees, plan sponsors retain several essential duties. Chief among these responsibilities are investment option selection and monitoring. These critical tasks require adherence to fiduciary standards of conduct. Failure to follow these standards may have serious consequences for the plan participants, organization, and plan fiduciary.

The purpose of this White Paper is to help plan sponsors understand how they can manage their investment responsibilities as the fiduciary of a defined contribution plan subject to the Employee Retirement Income Security Act of 1974 (ERISA), the law that governs how defined contribution plans operate. For the purposes of this White Paper, "plan sponsors" are assumed to be "plan fiduciaries," and the titles are used interchangeably.

The information provided has been assembled by LIMRA, one of the oldest, largest and most respected financial services research associations, and Transamerica Retirement Solutions, one of the leading providers of retirement plan services in the United States. While the White Paper does not provide legal advice or guidance of any kind, it offers useful background and analysis regarding some of the options available. Before making decisions on behalf of a plan, plan sponsors should consult with a qualified attorney.

Who is a plan fiduciary?

A plan fiduciary may be named a "plan fiduciary," "administrator," or "trustee" in a formal document governing the plan or a memorandum that has been distributed within the organization. In addition, ERISA makes it quite clear that *what an individual does, rather than how an individual's role is described*, may also determine whether or not they are a plan fiduciary. According to recent guidance from the Department of Labor (DOL), "using discretion in administering and managing a plan or controlling the plan's assets makes that person a fiduciary to the extent of that discretion or control."

A plan must have at least one fiduciary (a person or entity) designated in writing who has control over the plan's operations. This named fiduciary can be identified by office or name. In some cases, a plan's fiduciary may be a committee or a company's board of directors. Fiduciaries may also include the trustee, investment advisers, all individuals exercising discretion in the administration of the plan, and members of a plan's administrative or oversight committee. Attorneys, accountants, and actuaries are generally not fiduciaries when acting solely in their professional capacities. The litmus test for determining whether an individual or entity is a fiduciary is whether or not they exercise discretion or control over the plan.

It is also important to note that there are a number of decisions made in connection with a plan that are solely business decisions. For example, the decisions to establish a plan, determine certain features or options, and amend or terminate the plan are business decisions not governed by ERISA. When making these decisions, an employer is acting on behalf of the business, not the plan, and therefore is not acting as a fiduciary. However, the person who implements these decisions is acting on behalf of the plan and, in carrying out these actions, may be a fiduciary.

> *"Two-thirds of employers indicate that understanding (and complying with) plan rules is important or very important to them, while one in five say it is their most important concern as a plan sponsor."*
>
> ***— LIMRA***

What are the standards of conduct for plan fiduciaries?

A plan fiduciary is held accountable to fiduciary standards of conduct, which require that the fiduciary act on behalf of the plan participants and their beneficiaries. Before implementing any plan actions, a fiduciary must consider the following questions:

- Is this solely in the interest of the participants and their beneficiaries, and with the exclusive purpose of providing a retirement benefit to them?
- Have the guidelines established in the plan documents been followed?
- Has a diverse selection of plan investment options been adequately provided?
- Is the plan incurring only reasonable expenses?
- Would experts view the manner in which the actions are being implemented as prudent?

The duty to act prudently is one of a fiduciary's central responsibilities under ERISA. Prudence focuses on the process for making fiduciary decisions. Therefore, it is essential for a plan sponsor to document the details of the decisions made and the reasoning behind them.

Following the terms of the plan documents is of equal significance. The documents serve as the foundation for the decisions a plan fiduciary makes. A plan fiduciary must understand the documents, review them periodically, and ensure that all the information in them is kept current. A fiduciary's actions may be measured against the guidelines established in the plan documents, so it is vital that the actions are consistent with the information recorded. Of course, the plan documents must be consistent with ERISA and other applicable law. To the extent the documents conflict with law, a fiduciary must follow the law rather than the plan documents.

How do the standards of conduct apply to plan-level investment decisions?

This White Paper examines each of the fiduciary standards of conduct as they pertain to plan-level investment decisions.

1. **Is the investment decision solely in the interest of the participants and their beneficiaries, and with the exclusive purpose of providing a retirement benefit to them?** The regulations specify a number of "prohibited transactions" for plan fiduciaries and other parties to avoid, as well as exemptions to these rules. What is important to remember is that in most cases parties who may be in a position to exercise influence over the plan are prohibited from making investment decisions that will benefit themselves at the expense of the plan and plan participants.

2. **Have the guidelines established in the plan documents with regard to plan investments been followed?** Some documents may require an annual review of plan investments, which must be performed and documented. Often plan documents are based on a template provided by a third party. In this case, the functions and responsibilities of the plan fiduciary, and those of other parties who may have a role in selecting, monitoring and replacing plan investments, or in reporting information regarding investment options to participants, must be clearly designated.

3. **Has a diverse selection of plan investment options been adequately provided?** In plans that give participants control over how they invest their funds, the fiduciaries' potential liability for the consequences of those decisions is limited. However, these plans must provide participants with a broad range of investment options. In order to take advantage of reduced fiduciary liability in participant-directed plans, the DOL regulations require that, at a minimum, all plans must offer at least three different investment options, so that employees can diversify their portfolios among investment categories, such as stocks, bonds or cash equivalents.

   Diversification helps to ensure that all plan participants have reasonable access to options that will reflect their investment objectives and risk tolerance, and enables them to better manage exposure to potential investment losses. Note, participants must be given sufficient information to make informed decisions about the investment options available in their plans. If an organization automatically enrolls employees in its plan, fiduciary liability can be limited by utilizing one of four types of investment alternatives that have been approved by the DOL as default options.

4. **Is the plan incurring only reasonable expenses?** While the regulations do not specify what constitutes permissible investment expenses, they do require that they be "reasonable." Since this can be a shifting standard, following an initial assessment, investment fees and expenses should be monitored to determine whether they continue to be reasonable.

5. **Would an expert view the manner in which the plan investment duties are being implemented as prudent?** This may be one of the most challenging fiduciary responsibilities for plan sponsors. Plan sponsors are increasingly relying on third-party investment professionals, such as designated investment managers (commonly referred to as Section 3(38) investment managers) or investment selection and monitoring services (commonly referred to as Section 3(21) investment fiduciary services), to help make plan-level investment decisions.

> *"Choosing plan investment options is the number one reason why plan sponsors use outside advisors."*
>
> ***— LIMRA***

What is 3(38) Investment Fiduciary Management? When and why would it be utilized?

A 3(38) investment manager is responsible for selecting, monitoring, and replacing plan investment options. By utilizing an investment manager, a plan sponsor "transfers" some of the fiduciary responsibility for plan-level investment functions to the manager, and as a consequence, has an opportunity to mitigate potential fiduciary liability. However, the plan sponsor and/or the committee charged with the administration of the plan remain as plan fiduciaries, and, therefore, are still obligated to prudently select and monitor the investment manager.

ERISA requires that a 3(38) investment manager have the authority to manage, acquire or dispose of plan assets; is a registered investment advisor (RIA), insurance company or bank; and acknowledges their ERISA fiduciary status as a designated plan investment manager in writing.

The DOL requires plan fiduciaries to "engage in an objective process that is designed to elicit information necessary to assess the provider's qualifications." A prudent process would likely include the following actions:

- A review of the manager's professional and educational background, and professional designations
- An examination of the manager's years of experience, history of delivering comparable services to plans subject to ERISA, and the reputation and experience of the firm which the manager represents
- Confirmation that no history of disciplinary action by the Securities and Exchange Commission, directed to either the manager or their firm, exists
- Verification that the manager maintains adequate fiduciary liability insurance
- Assessment that the fees charged by the manager are reasonable
- Determination that no conflicts of interests, which could impact the manager's investment decisions, exist

The selected investment manager produces a written agreement documenting the scope of their roles and responsibilities, including a detailed description of the process they will use to put into effect their jurisdiction over plan investments. In addition to incorporating the language often found in an Investment Policy Statement, such as a restatement of plan investment selection guidelines* and/or a reference to the specific investment needs and investing abilities of the participant population, the agreement may also stipulate benchmarks for evaluating the performance of the investment options and investment manager, and the type of reporting the investment manager will provide. Both the frequency and medium of delivery for the reports should be noted.

What are 3(21) Investment Fiduciary Services? When and why would they be utilized?

Use of a 3(21) service does not signify a "handing over" of plan-level investment decision-making to a third-party. Instead, it is a tool that can be employed by plan sponsors and their advisors to varying degrees, depending on their desired level of involvement in making those decisions themselves. The provider of the 3(21) service becomes an investment fiduciary to the plan for certain elements of investment screening and monitoring, but lacks the discretion to make the plan-level investment changes that are ultimately controlled by the plan sponsor.

With 3(21) services, the plan sponsor receives a third-party certification that the screening, monitoring and replacement processes utilized by their retirement services provider, for all or some of the investments made available to the plan sponsor, adhere to a "prudent expert" standard. Alternatively, through the operation of 3(21) services, the plan sponsor may have access to a pre-screened investment lineup that correlates to the plan's participant demographics. As with the obligation to investigate the credentials of a 3(38) investment manager, plan fiduciaries must ascertain the reputation, experience and methods of the provider of 3(21) services. However, there is a view that the level of oversight for a 3(21) service is less demanding for plan sponsors than for a 3(38) service, as the 3(21) provider has no discretionary role with respect to plan investments.

> *"Four in 10 sponsors with plan assets of less than $1 million rely on third parties for determining plan investment options — almost seven in 10 with assets over $5 million do so."*
>
> ***— LIMRA***

What should be considered when deciding whether to use 3(21) Investment Fiduciary Services or 3(38) Investment Fiduciary Management?

Ultimately, the decision rests on three factors: cost, control and confidence.

All services have costs. 3(21) services are sometimes included in a bundled services arrangement, while 3(38) investment services typically involve an explicit fee. Each service provides different levels of fiduciary liability mitigation for the plan sponsor, and correspondingly, fiduciary liability exposure for the service provider. A plan sponsor has a fiduciary duty to determine whether or not the service meets their requirements, and at a reasonable cost. As a general rule, the cost of obtaining 3(21) services is less than 3(38) services.

Plan sponsors should also consider how much control they, or other plan advisors, intend to exercise with regard to plan investments. At one end of the spectrum, plan fiduciaries assume responsibility for all plan-level investment decisions and their consequences. Near the other end, under a 3(38) arrangement, day-to-day plan-level investment decision-making is delegated to a third party under an agreed set of rules, while plan fiduciaries retain ultimate responsibility for overseeing their work. Somewhere in the middle of the spectrum operates the 3(21) model, in which plan sponsors and their advisors rely upon a third party's prudent process for investment screening and monitoring as the starting point for the plan-level investment decisions that they eventually make.

Finally, plan sponsors should consider the level of support they need in order to have the confidence to make prudent decisions for their plans.

Conclusion

By offering a defined contribution plan, employers can provide desirable retirement benefits to their employees. However, establishing and maintaining a plan can be challenging, especially as it pertains to plan-level investment decisions. Although tools exist that can help make this responsibility much more manageable, the regulatory environment and recent lawsuits have created a focus on the role of plan fiduciaries, particularly in the area of investment options available to plan participants.

The purpose of this White Paper is to help plan fiduciaries understand their roles, and the resources available to assist them, in making investment decisions for their plans that meet the fiduciary standards of conduct.

Transamerica or Transamerica Retirement Solutions refers to Transamerica Retirement Solutions Corporation. Transamerica is not affiliated with LIMRA.

* There is an opposing school of thought, which suggests that a plan sponsor should offer minimal guidelines to a 3(38) investment fiduciary on the theory that this will further distance the plan sponsor from the manager's actions. In the author's view, this approach may lessen some fiduciary risks, while simultaneously increasing others.

About Transamerica Retirement Solutions

Transamerica Retirement Solutions (Transamerica) is a leading provider of customized retirement plan solutions for small- to large-sized organizations.

Transamerica partners with financial advisors, third party administrators, and consultants to cover the entire spectrum of defined benefit and defined contribution plans, including: 401(k) and 403(b) (Traditional and Roth); 457; profit sharing; money purchase; cash balance; Taft-Hartley; multiple employer plans; nonqualified deferred compensation; and rollover and Roth IRAs.

Transamerica helps more than three million retirement plan participants save and invest wisely to secure their retirement dreams. For more information about Transamerica Retirement Solutions Corporation, please visit **www.TRSretire.com**.

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This paper is general in nature and not intended as tax or legal advice. Because each employer is unique, an employer should consider its individual circumstances when evaluating a defined benefit plan administrative solution and should consult their retirement plan and/or legal advisor.

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