

Strategies for Plan Fiduciaries Amidst Market Volatility



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Overview

- Risk management strategies for dealing with market volatility
- Understanding “hot button” compliance issues
- Checklists

Risk Management Strategies for Market Volatility



5 Key Risk Management Strategies for Plan Fiduciaries in an Environment of Market Volatility

1. Understand everyone's role.
2. Implement appropriate structures and processes.
3. Utilize your investment professionals.
4. Scrutinize investment alternatives, avoid trends, be wary of inertia, and make appropriate changes.
5. Develop and implement robust participant education.

Strategy #1: Understand Everyone's Role

- Understand everyone's role for your organization's retirement plan.
 - Fiduciaries under ERISA – a functional definition. A person is a fiduciary to the extent he:
 - Exercises discretionary authority or discretionary control over management of the plan or disposition of its assets
 - Selecting and monitoring investments
 - Selecting and monitoring plan service providers, like recordkeepers
 - Renders investment advice for a fee with respect to plan assets
 - Has discretionary authority or responsibility in the administration of the plan
 - Decides what changes should be made to a retirement plan
 - Makes decisions about how benefit claims should be handled, especially denials

Strategy #1: Understand Everyone's Role (cont'd)

- For those who are plan fiduciaries, 5 key duties (which can be delegated)
 - #1: Duty of loyalty
 - Act solely in the interests of plan participants, for the exclusive purpose of providing benefits to them and defraying reasonable plan expenses
 - #2: Duty of prudence
 - Act with the care, skill, and diligence that a reasonable person, who is familiar with these matters, would use under the same circumstances
 - #3: Duty of diversification
 - Diversify plan investments, in order to protect against the risk of large investment losses and to defray reasonable expenses (no guarantee or results)
 - #4: Duty to follow plan terms
 - #5: Duty to avoid self-dealing/prohibited transactions

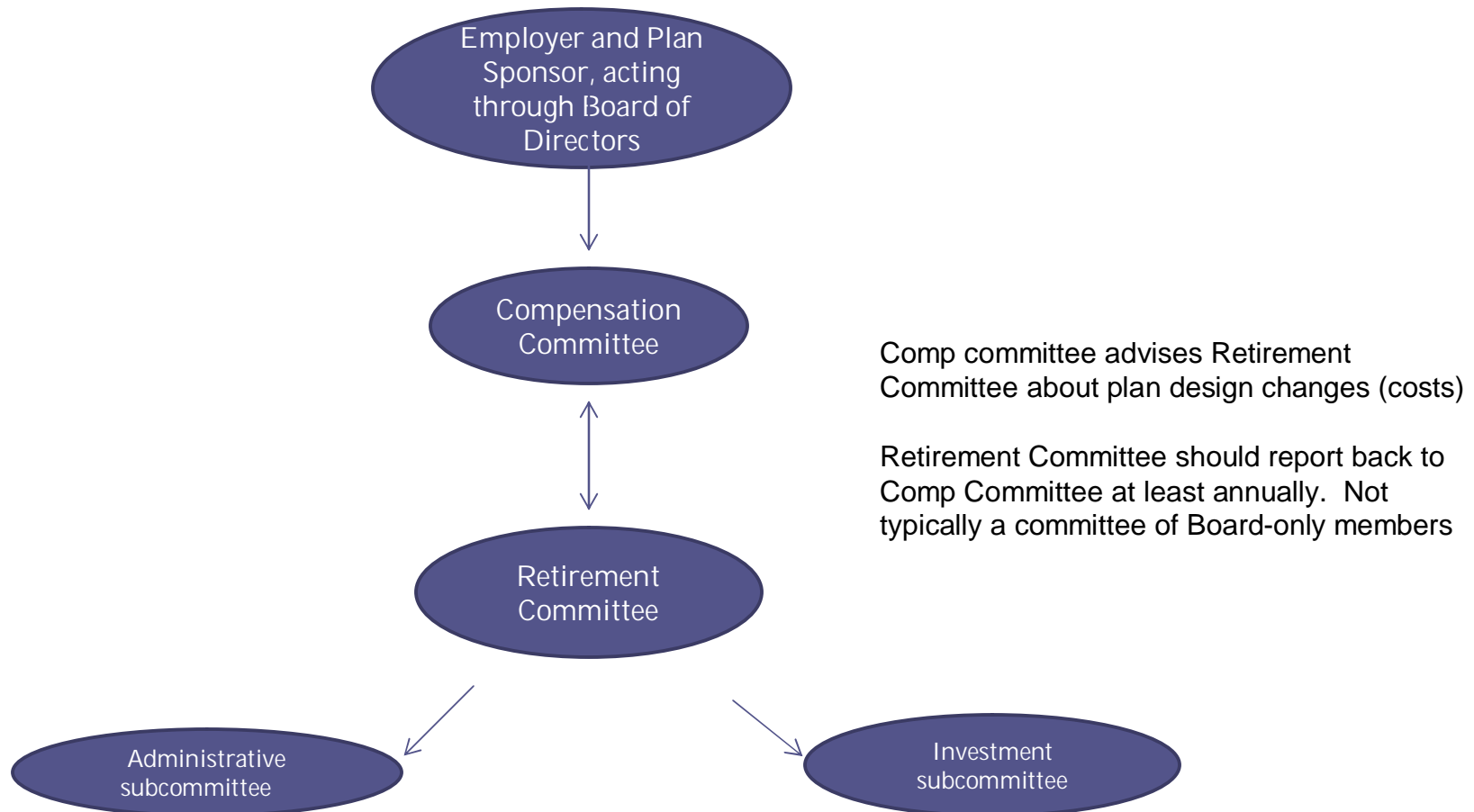
Strategy #1: Understand Everyone's Role (cont'd)

- Who is a fiduciary?
 - Plan sponsor/employer
 - Board of Directors
 - Retirement Plan Committee
 - Plan Trustee (but may be limited to “directed” trustee role)

- Who is likely not a fiduciary?
 - Service providers – plan recordkeepers, actuaries, accountants, lawyers, consultants
 - Investment professionals
 - Staff who perform administrative and ministerial functions

Strategy #2: Implement Appropriate Structures and Processes to Manage Fiduciary Responsibility

- Establish the right committee with clear delegation of authority and reporting duties



Strategy #2: Implement Appropriate Structures and Processes to Manage Fiduciary Responsibility (cont'd)

- Establish the right Committee
 - Duties delegated from Board or Comp Committee
 - Oversight of plan investments, expenses and administration
 - Recommendations regarding changes with non-material economic impact (to be adopted by Comp Committee or Board)
 - Coordination of audit and other compliance functions

Strategy #2: Implement Appropriate Structures and Processes to Manage Fiduciary Responsibility (cont'd)

- Establish the right Committee
 - Membership
 - Number
 - Constituencies (HR, Finance, Legal)
 - Written charter featuring:
 - Clear delegation of authority and need to report
 - Membership, including resignation/removal
 - Meeting protocols (quorum, voting, approval)
 - Indemnification rights (also through corporate bylaws, individual agreements, etc.)
 - How charter can be amended

Strategy #2: Implement Appropriate Structures and Processes to Manage Fiduciary Responsibility (cont'd)

- Implement good procedures for Committee decision-making
 - Regular meetings (quarterly preferred)
 - Agendas & minutes – keep good records
 - Fiduciary training
 - Updates on new developments
 - Interactive, engaged, deliberative decision-making
 - Avoid having a “clean heart but empty head”

Strategy #2: Implement Appropriate Structures and Processes to Manage Fiduciary Responsibility (cont'd)

- Implement good procedures for Committee decision-making
 - Disciplined and frequent review of both plan investments and overall plan performance
 - Plan contribution levels
 - Concentration in particular investments
 - Investment returns
 - Plan fees
 - Compliance (nondiscrimination testing, correction of plan errors)
 - Vendor performance
 - Follow up on open items from prior meetings
 - Especially important with review of investments that may be on a “watch” list

Strategy #2: Implement Appropriate Structures and Processes to Manage Fiduciary Responsibility (cont'd)

- Maximize 404(c) protection from self-directed investments, recognizing that plan fiduciaries are still responsible for selecting and monitoring investment options
 - At least 3 different options for diversification, with opportunity to change investments at least quarterly
 - Participants must get sufficient information to make informed decisions
 - Special considerations with self-directed brokerage windows
 - Enhanced protection with designation of “qualified default investment alternatives” (“QDIAs”)
 - Target date or lifecycle funds
 - Balanced funds of equity-fixed income
 - Managed accounts using target date or lifecycle approach

Strategy #2: Implement Appropriate Structures and Processes to Manage Fiduciary Responsibility (cont'd)

- Develop a written Investment Policy Statement
 - Not technically required – but a “best practice”—often on the short list of documents DOL auditors want to review
 - Sets forth Committee’s goals for plan investments
 - Asset allocation strategies
 - Benchmarks for evaluation
 - Standards for when funds will be replaced
 - Needs periodic review and updates as investment changes are made

Strategy #2: Implement Appropriate Structures and Processes to Manage Fiduciary Responsibility (cont'd)

- Implement effective compliance measures
 - Timely contribution of employee contributions
 - As soon as they can be segregated from company assets
 - No later than the 15th of the month following payday
 - Nondiscrimination testing
 - Timely and full correction of plan errors, with missed earnings
 - Disclosure obligations
 - Annual notices – QDIA, safe harbor, auto enrollment
 - Fee disclosure – coming in 2012!
 - SPDs, Summary Annual Reports, Funding Notices
- Obtain sufficient ERISA bonding and fiduciary liability insurance

Strategy #3: Utilize Your Investment Professionals

- Use your plan's professional investment advisors to provide sufficient information to navigate volatility and understand:
 - Investment performance – recent and long-term perspective
 - Deviations from original strategies set forth in Investment Policy Statement
 - Drift
 - Over-diversification & dilution
 - Redundancy
 - Fee options
 - "Hidden" fees
 - Different share classes
 - Alternative investment options

Strategy #4: Scrutinize Investment Alternatives and Make Appropriate Changes

- Scrutinize each plan's investment alternatives – “top-down” look at plan as a whole
- Be wary of both trends and inertia, but consider alternatives that can blunt or smooth out volatility in markets
 - Know yourself and your organization – not every trend is right for you
 - In today's economic climate, engage your professionals to assess
 - Fees
 - Diversification & asset allocation strategy
 - The role of index funds
 - Sufficient range of fixed income alternatives
 - Hedge funds, inflation fighting assets (TIPS, real estate, commodities)
 - Refrain from responding to volatility by changing plan design
- When appropriate implement changes
 - Avoid being reactionary or paralyzed by fear
 - Implement methodically – timing and mapping are important fiduciary considerations

Strategy #5: Develop and Implement Robust Participant Education

- 2012 presents a “perfect storm” for renewed focus on robust investment education for participants
 - A prudent response to market volatility
 - Impending compliance obligation in 2012 to provide enhanced disclosure of fees
 - Risk management strategy of enhancing 404(c) protection
- Wide range of available alternatives, sharing same goals:
 - Ensuring each participant knows his individual objectives – “magic number”
 - Optimizing use of tools offered by plans to achieve those objectives
 - Contribution opportunities (employees & company)
 - Investment choices (risk, performance & fees)
 - Distribution opportunities (in-service distributions for investment outside of plan)

“Hot” Compliance Issues and Mitigation Strategies

A decorative graphic consisting of a solid teal horizontal bar at the top, followed by a white horizontal bar, and then three thin, parallel teal horizontal lines on the right side of the white bar.

General Observations About “Hot” Compliance Issues

- Higher visibility of retirement plan issues
- Increased rigor of plan audits by independent auditors & by IRS, resulting in numerous plan corrections
- Activist posture of Department of Labor
 - Increased audit activity
 - Increased plan litigation

“Hot” Compliance Issues

- Timely deposit of employee contributions
- Diversion of plan assets for corporate purposes, to help fund companies experiencing economic distress
- Drop in asset values, especially if company stock is one of the plan’s investments
- Failure to follow plan terms
 - Eligibility/exclusion of individuals
 - Compensation definition

What is at risk?

- Restoration of plan benefits
- Monetary (civil) penalties for wide range of violations
 - 20% for breach of fiduciary duty
 - Daily penalties for failure to provide information
- Penalty excise taxes (prohibited transactions)
 - 15% of amount involved
 - 100% if prohibited transaction not corrected or “unwound”
- Personal liability for breach of fiduciary duties
 - For your own fiduciary conduct
 - For the conduct of your co-fiduciaries, if you have knowledge of their breach and you fail to stop or remedy any breach of which you are aware

Checklists



Strategies to Mitigate Risks

- Understanding everyone's role
- Fiduciary due diligence – with right committee & right processes in place
- Utilization of professional advisors
- Quality control – thorough oversight of plan administration and implementation of appropriate changes to plan investments
- Robust participant education

Checklist of Key Documents

- Committee charter & delegation of authority
- Investment policy statement
- Minutes and periodic reports to Board or Compensation Committee
- Executed plan documents
- Executed contracts with all plan fiduciaries and service providers
- ERISA bond
- Fiduciary liability insurance
- Indemnification agreements