3(38) Fiduciary Versus 3(21) Fiduciary: What Are the Real Duties and Risks?

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Most Plan Sponsors Have Confusion About Their Fiduciary Status and Duties

Unified Trust 2009-2010 survey of plan sponsors (non Unified trust clients) revealed the following observations:

1) 53% did not think of themselves as a fiduciary

2) 52% thought a Fiduciary Warranty would defend them from a participant lawsuit

3) 48% understood that the fiduciary must only be loyal to the plan participant

4) 57% understood that the fiduciary standard of care is that of an expert

Most Plan Sponsors Have Confusion About Their Fiduciary Status and Duties

Unified Trust 2009-2010 survey of plan sponsors (non Unified trust clients) revealed the following observations:

5) Most (59%) think their vendor accepts full discretion and liability, while they almost certainly do not.

6) Finally an astonishing 95% are either “very comfortable” or “somewhat comfortable” that they have taken every reasonable precaution to insulate themselves against legal challenges stemming from a breach of fiduciary responsibility.

DOL Expects to Increase Enforcement Personnel from 913 to 1,003 this Year

DOL Cracks Down on Retirement Plan Advisors for Fiduciary Negligence

Advisors and plan sponsors are surprisingly still unaware that DOL has jurisdiction over them, says Larson of Retirement Learning Center

BY MELANIE WADDELL, ADVISORONE
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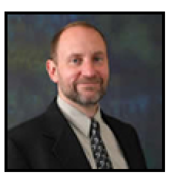
So far this year, the Department of Labor's Employee Benefits Security Administration (EBSA) has significantly raised its enforcement efforts in what Andy Larson, director of the Retirement Learning Center, said should serve as a wakeup call to advisors who advise retirement plans and plan sponsors.

In 2011, EBSA said it had closed 3,472 civil cases and obtained monetary results of nearly $1.39 billion. EBSA also closed 302 criminal cases that resulted in 129 individuals being indicted and 75 cases being closed with guilty pleas and/or convictions. DOL also wants to increase the number of its enforcement personnel from 913 to 1,003 this year.



In an interview with AdvisorOne, Larson (left) called those EBSA enforcement numbers "astonishing," and warned that many advisors are surprisingly still unaware that the DOL has jurisdiction over them.

What's the biggest area EBSA is zeroing in on? Fiduciary negligence. EBSA is "seeing very high levels of non-compliance with fiduciary" duties. And when the EBSA releases its re-proposed fiduciary rule in the first half of this year, the rule "will affect advisors and their fiduciary role" not plan sponsors, Larson says.

ERISA 404(a)(1) “Gold Standard” of Conduct

…a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and – for the exclusive purpose of:

(i) providing benefits to participants and their beneficiaries; and
(ii) defraying reasonable expenses of administering the plan;

Plan Sponsor Fiduciary Conduct Begins With the Duty of Loyalty

The Duty of Loyalty is to the plan participants and their beneficiaries ERISA 404(a)(1)(A) requires that in discharging his fiduciary duties, the fiduciary's decisions….

"Must be made with an eye single to the interests of the participants and beneficiaries."

Donovan v. Bierworth, 680 F.2d 263, 271 (2d Cir.),cert. denied, 459 U.S. 1069 (1982)

Plan Sponsor Fiduciary Duties Require the Highest Standard of Care

404(a)(1)(B) requires that in discharging his fiduciary duties, the fiduciary must act….

"With the care, skill, prudence, and diligence under the circumstances then prevailing that a <u>prudent man</u> acting in a like capacity and <u>familiar with such matters</u> would use in the conduct of an enterprise of a like character and with like aims."

Plan Sponsor Fiduciary Duties Require the Highest Standard of Care

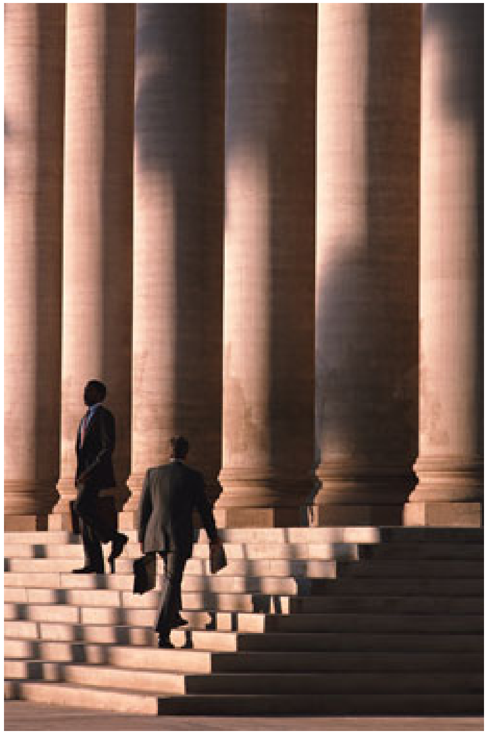
Fiduciary duties under ERISA….

"are the highest known to law."

Donovan v. Bierworth, 680 F.2d 263, 271 (2d Cir.),cert. denied, 459 U.S. 1069 (1982)

When enforcing these duties, **"the court focuses not only on the merits of the transaction, but also on the thoroughness of the investigation into the merits of the transaction."**

Donovan v. Cunningham, 716 F.2d 1455, 1467 (5th Cir.) (1983)



The Prudent Process Always Involves Two Parts & Five Steps

Procedural Prudence:

1) Consider what information is relevant to the decision
2) Obtain the information
3) Analyze the information

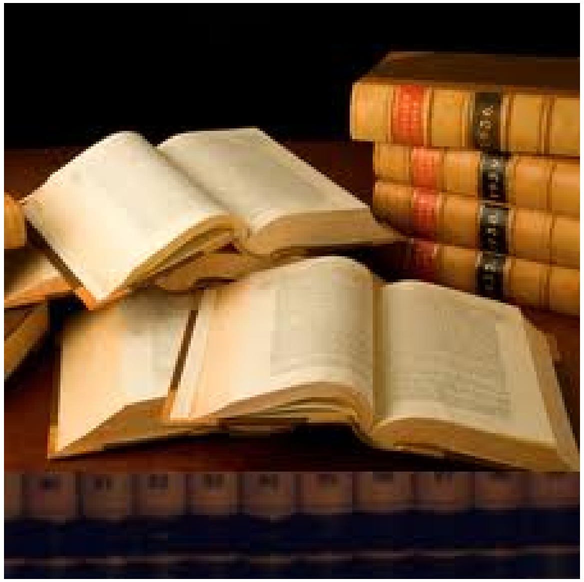
Substantive Prudence:

1) Make a reasoned decision that other experts in similar situations would make
2) Document the decision

The Plan Fiduciaries May Need to Seek an Outside Expert

"Where a trustee does not possess the education, experience and skill required to make a decision concerning the investment of a plan's assets, he has an affirmative duty to seek independent counsel in making the decision."

Katsaros v. Cody, 744 F.2d 279 (2d Cir.), (1984)



It May Be Imprudent for the Plan Sponsor to Not Use an Outside Expert

"The failure to seek outside counsel when "under the circumstances then prevailing ... a prudent man acting in a like capacity and familiar with such matters" would seek outside counsel, is imprudent and a violation of ERISA."

Katsaros v. Cody, 744 F.2d 279 (2d Cir.), (1984)

However—The Plan Sponsor May Not "Blindly" Follow the Expert

"While we would encourage fiduciaries to retain the services of consultants when they need outside assistance to make prudent investments and do not expect fiduciaries to duplicate their advisers' investigative efforts,) we believe that ERISA's duty to investigate <u>requires fiduciaries to review the data</u> a consultant gathers, to assess its significance and to supplement it where necessary. "

Unisys Savings Plan Litigation, 74 F. 3d 420 (3rd Cir.), (1996

Market Demand for Independent Fiduciary Consulting is Increasing

Top 3 services plan sponsors seek are: investment assistance, improvement of plan performance, and assistance with fiduciary concerns.[1]

Plan advisors seek to differentiate themselves from growing “me too” competition, fee compression and add value.

Independent Fiduciary Consulting

1 The 2010 Fidelity Investments Plan Sponsor Attitudes Survey, which included responses from 503 employers ranging in size from 25 to 2500 participants.

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What are the duties of an ERISA §3(21) Fiduciary?

- How it’s different from the co-fiduciary level?
- Limited scope vs. full scope

What are the duties of an ERISA §3(21) Fiduciary?

- “Investment manager”
- How it’s different from the 3(21) level?
- Not for every advisor or every plan

Due Diligence and the ERISA §3(38) Fiduciary

- Hiring a fiduciary is part of the fiduciary process
    - Anyone can claim they are a 3(38)
    - The Towers case, great insight on what plan sponsors need to do

Tips on becoming an ERISA §3(38) Fiduciary

- Don’t jump in
  - Learn what it takes
  - Partner with an existing §3(38) fiduciary
  - Work with an ERISA attorney
  - If you decide to jump, contact your insurance carrier

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By: Dr. Gregory Kasten
Unified Trust Company

Trustee Status Can Impact 3(38) and 3(21) Advisory Services

SELF-TRUSTEE
Most common, individual or group of individuals (owners)

DIRECTED CORPORATE TRUSTEE
Accepts title of trustee, serves as custodian, passive or name-only

DISCRETIONARY CORPORATE TRUSTEE
An institutional body, bank or trust company, accepting full discretion and liability for the prudent management of plan assets

Court Cases Demonstrate the Protection of a Discretionary Trustee Implementing a Prudent Process

"Since this Court has found that State Street Bank did not commit a breach of its fiduciary duties, WR Grace prevails as well…."

"If State Street Bank did not commit a breach, then WR Grace did not fail in the discharge of its duty to select and monitor State Street Bank."

WR Grace Plan and State Street Bank Litigation,
Case 04-11380-WGY (2008)

3(38) Investment Manager Business Model and Case Study

How does this impact the participant experience?

Will more participants retire successfully from these actions?

"…Must be made with an eye single to the interests of the participants and beneficiaries."

Can the advisor demonstrate a tangible value proposition, above the intangible?

3(38) Investment Manager Business Model Generally Focuses on Plan Level Activity

1) Investment Policy Statement
2) Initial Fund selection
3) Ongoing fund monitoring and replacement when indicated
4) Meet with Retirement Committee quarterly
5) Document actions and record meeting minutes

There Are Additional Actions---Who Will Provide These Services?

6) Model portfolio construction and monitoring

7) QDIA selection

8) ACA, EACA, and QACA Participant Notices

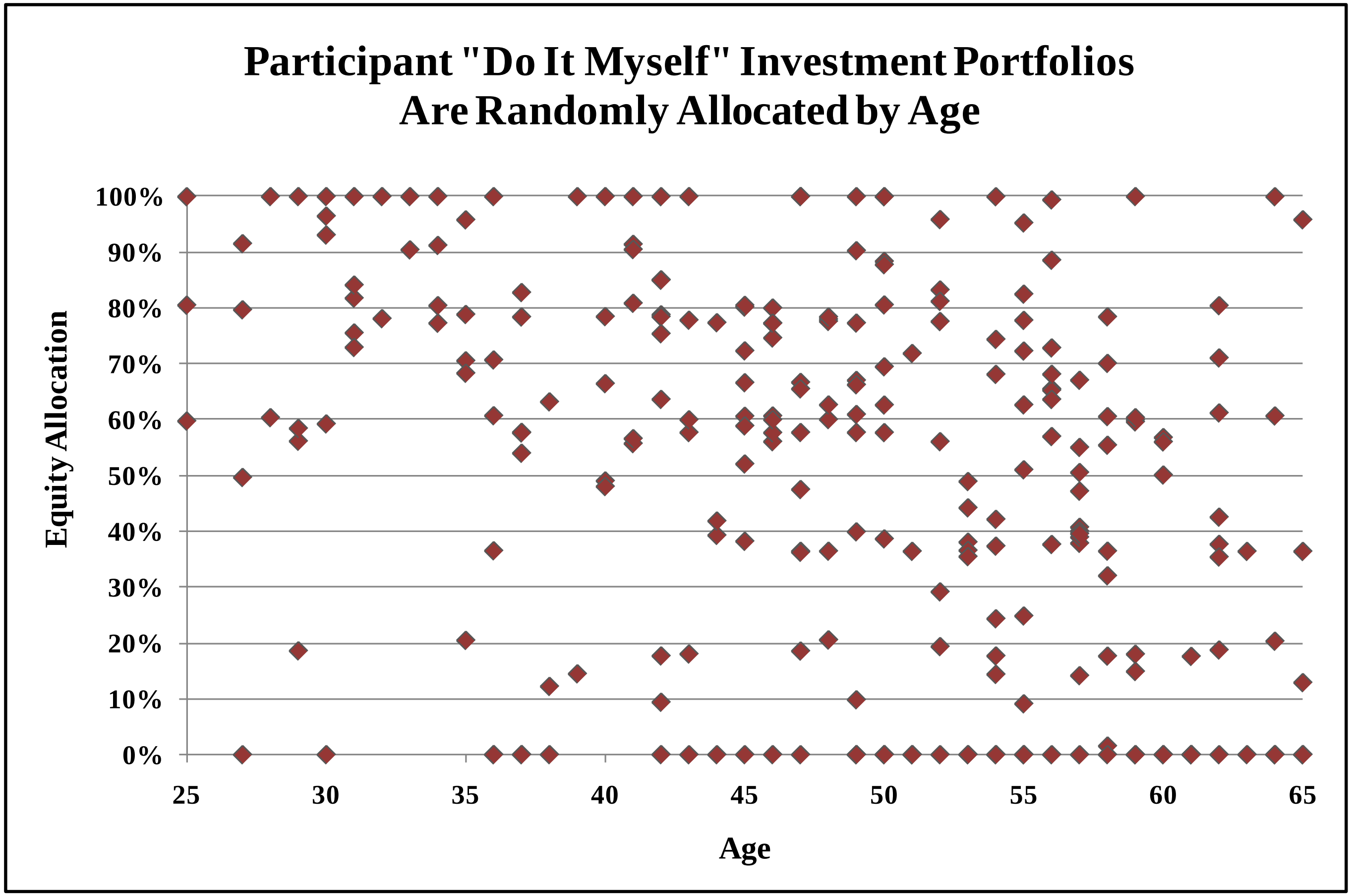
9) Responsible for determining if plan fees are reasonable for services

10) Duty to avoid prohibited transactions and also monitor full plan for them

11) Document prudent and appropriate portfolios at the participant level

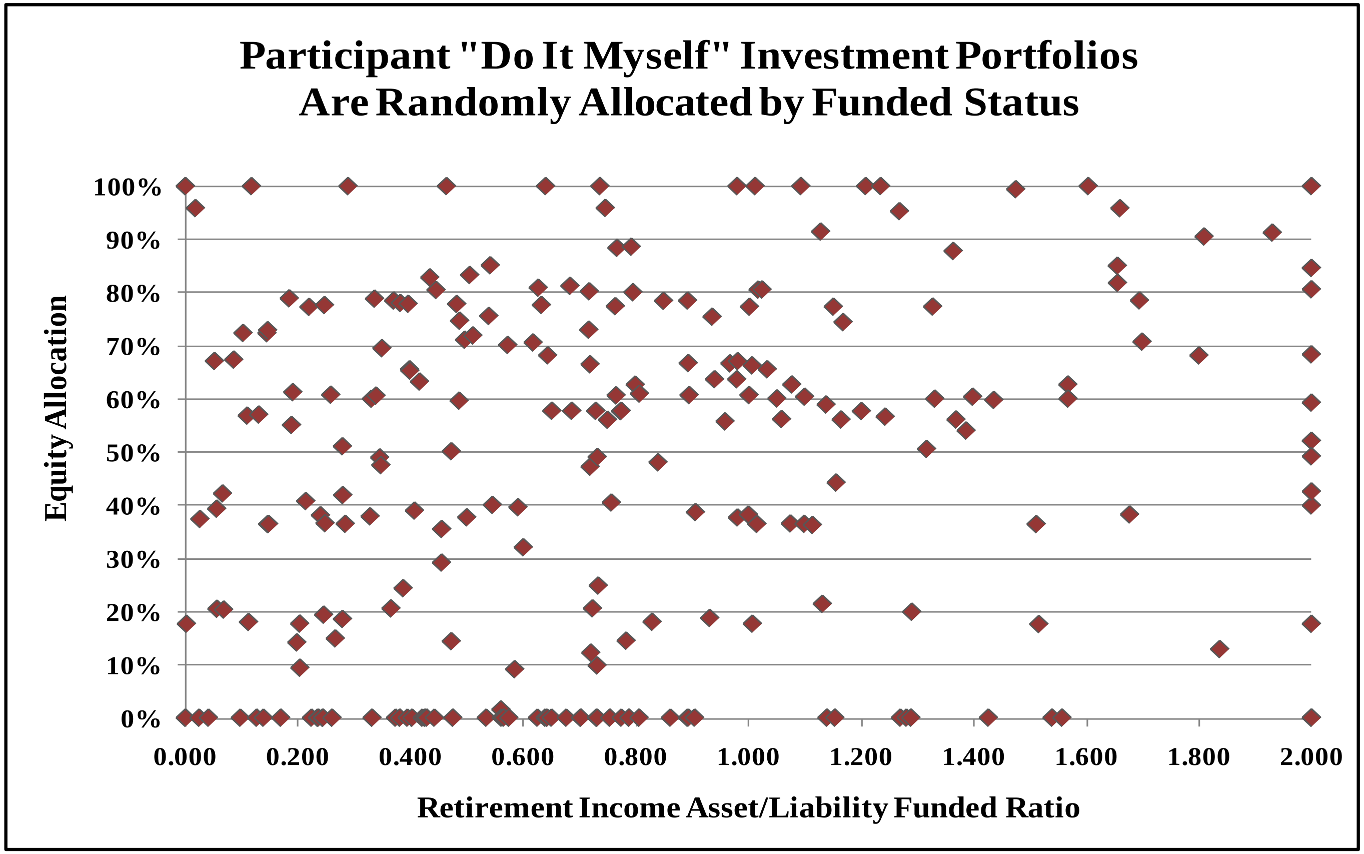
Even with Good Plan Level Fiduciary Metrics—Many Participants Will Be Invested Poorly and Not On Track for Retirement Success

Participant Investing Is Mostly Random and Not Related to Time Horizon



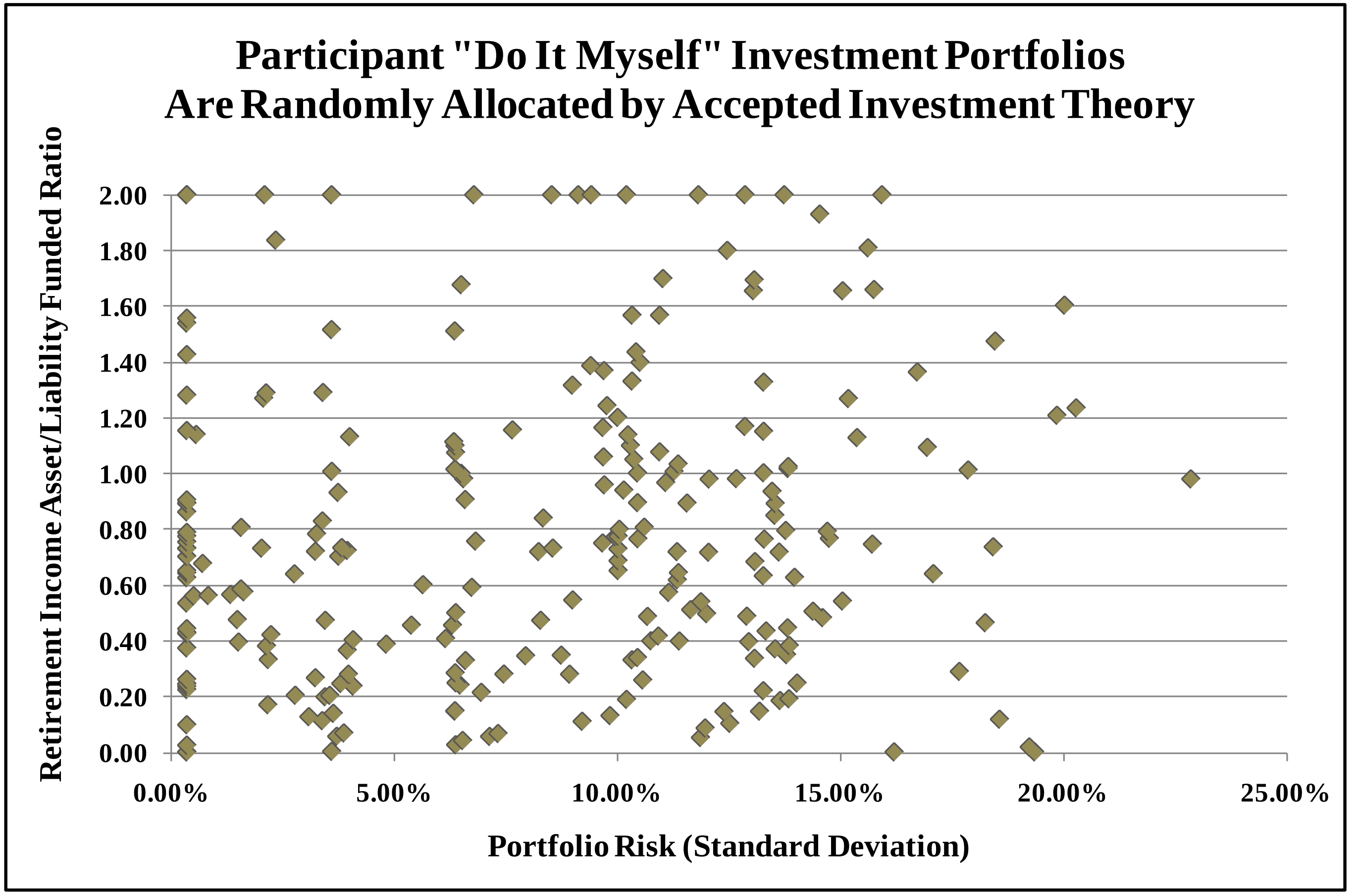
Data as of December 31, 2011 for participants "opting out" of the UnifiedPlan..

Participant Investing Is Mostly Random and Not Related to Benefit Funded Status



Data as of December 31, 2011 for participants “opting out” of the UnifiedPlan..

Participant Investing Is Mostly Random and Does Not Follow Generally Accepted Investment Theory



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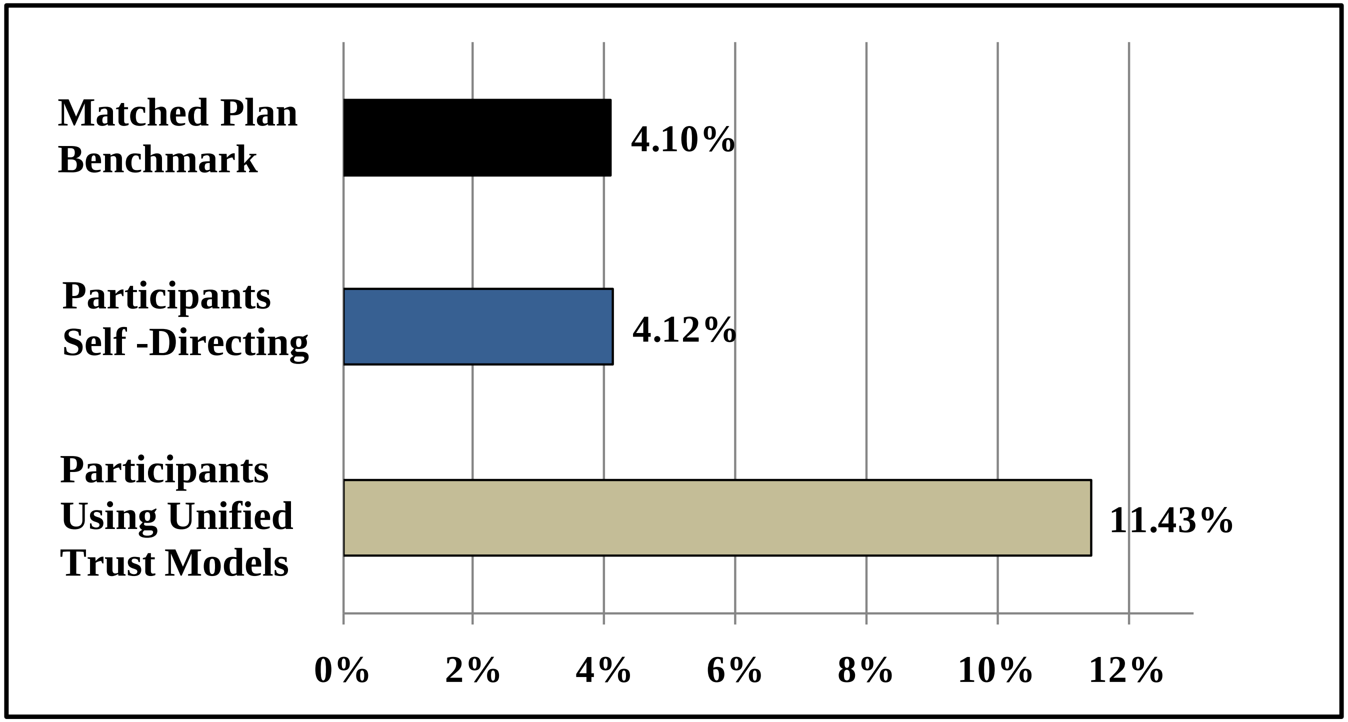
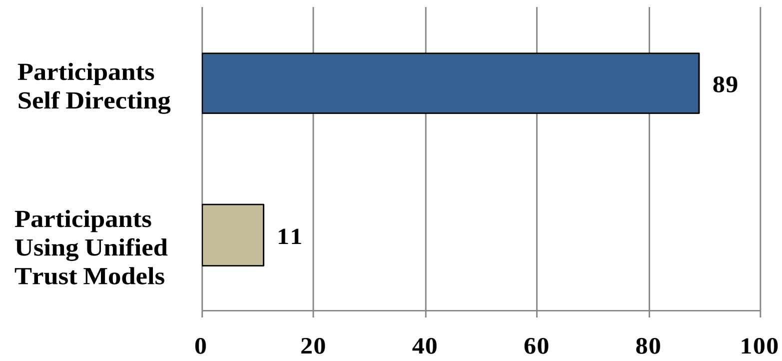
Participants in Model Portfolios Had Better Returns than Those Who Selected Their Own Funds from Prudent Lineup



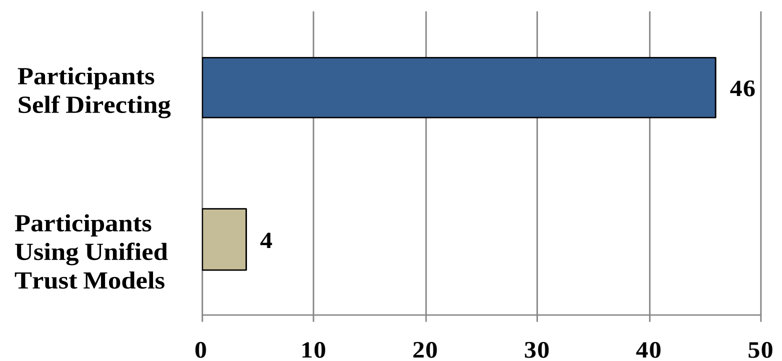
425 Participant data (51% self direct and 49% in models) as of December 31, 2011 for 2007-2011 five year time period.

Participants in Model Portfolios Had Less Risk Than Those Who Selected Their Own Funds from Prudent Lineup

100 Worst Returns in 2008



50 Worst Returns in 2008



425 Participant data (51% self direct and 49% in models) as of December 31, 2011 for 2007-2011 five year time period.

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3(38) Investment Manager Business Model Generally Focuses on Plan Level Activity--But What About Participants?

What is the participant's income replacement goal?

Are they on track for a fully funded benefit?

How do you know what portfolio is appropriate for each participant?

Are they in a model? Which one? Are you sure?

How do you know they are in it today?

How do you know if their asset allocation is on efficient frontier?

How do you know if they were re-balanced?

How many hold multiple TDF's or multiple funds with TDF?

Which of These Factors Is Responsible for Retirement Success?

____ Top Down (Plan Level)

____ Bottom Up (Participant Level)

____ All of the Above

____ None of the Above

Which of These Factors Is Responsible for Retirement Success?

____ Top Down (Plan Level)

____ Bottom Up (Participant Level)

__X__ All of the Above

____ None of the Above

Both Plan Level and Participant Level Metrics Are Required for Retirement Success

3(38) or 3(21) advisor can focus on plan design and plan level fiduciary metrics, along with interactions with selected individual participants

Discretionary plan trustee provides "failsafe" fiduciary oversight, individualized prudence verification and actuarial implementation of participant metrics

Holistic Approach for Retirement Success

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Questions?

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