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How to Bulletproof a 401(k) Plan – Procedurally - from Fiduciary Breach Risk

You Don't have to be a Mega Plan to be concerned!

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April 4, 2019

CEFEX Analysts

CEFEX CENTRE FOR FIDUCIARY EXCELLENCE

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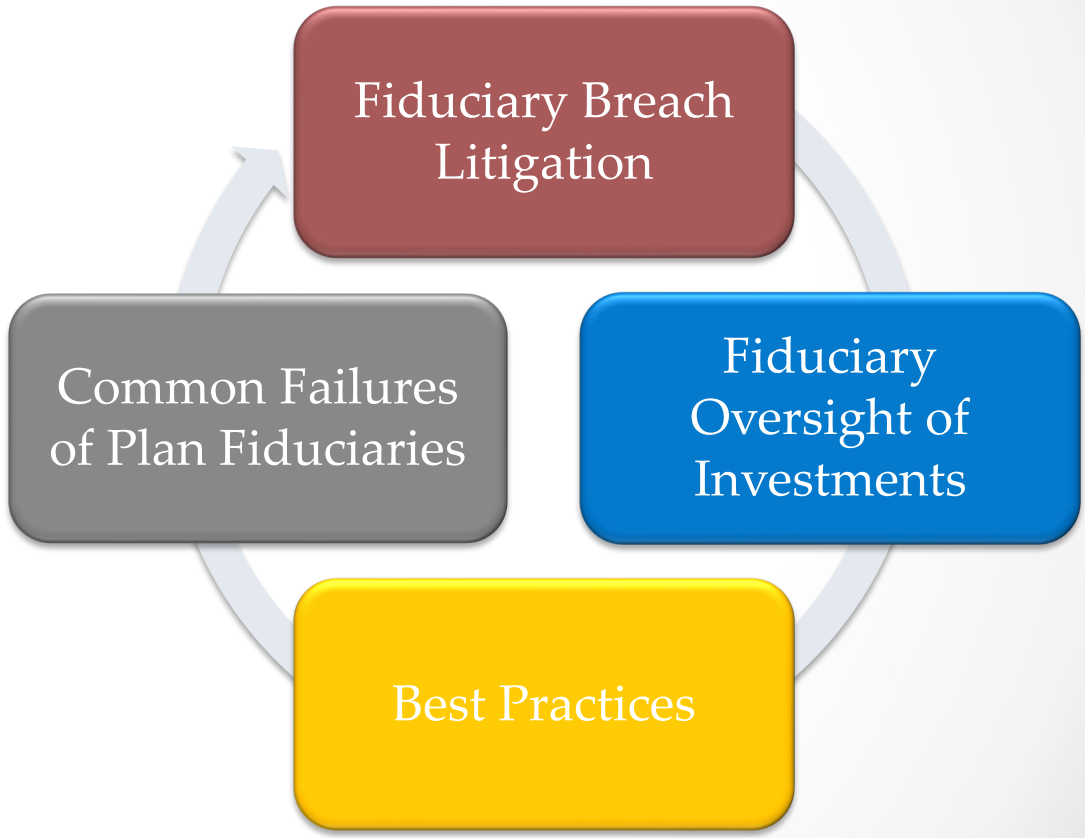
Lessons From 401(K) Fiduciary Breach Litigation

You Don't Have to be a Mega Plan to be Concerned!



Prudent Expert

Plan Fiduciaries must be sufficiently knowledgeable to act as “prudent experts”, or they should engage an independent expert to help them conform to a fiduciary standard of care

- Fiduciaries are taken to understand their responsibilities.
- Depositions of investment committee members often elicit “I don’t remember” or “someone else was responsible for that” responses. Neither answer breeds credibility.
- Better to hire an expert than face the risks of ignorance.

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Investment Policy Statement (IPS)

Every 401(k) plan must have an IPS specific to the needs of the plan

- The IPS is the "Business Plan" by which the investment process is managed. It serves as the point of reference for fiduciary functions.
- There is no "one size fits all"
- The lack of an IPS is an indicator of fiduciary ignorance or disregard

Plan Fiduciaries must adhere to IPS

- Once established, the IPS must be followed and any deviation from its dictates must be explained and documented
- Persistent disregard is an indicator of imprudence

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Investment Committee

Retirement Plan Committee

- ✓ Plan Fiduciaries should hold periodic meetings to address investment and administration topics
- ✓ Plan fiduciaries are responsible for monitoring:
    - the needs of participants
    - investment performance
    - plan expenses
    - performance of third party service providers
    - the currency of plan documents and
    - conformity with administrative responsibilities

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Agenda

- ✓ An Agenda for each meeting should be set taking into account the requirements of the IPS:
  - Establish quorum (List those present, including service provider representatives)
  - Review and approve minutes of prior meeting
  - Address topics deferred from prior meeting
  - Review written reports and supporting documents
  - Consider and vote on recommendation

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Reports

- ✓ Reports prepared for meetings should conform to the dictates of the IPS
  - Investment and service provider reports should reflect monitoring criteria specified in IPS
- ✓ Documents presented at meetings requiring a decision should not be ignored
  - Investment recommendations should be discussed and a decision should be made
  - RFP responses should be discussed and a decision should be made
  - No recommendation should be ignored

Meeting Minutes

- ✓ Minutes of Plan Fiduciaries' meetings must be maintained by a someone knowledgeable about fiduciary matters (fiduciary Achilles heel)
  - A decision by the fiduciary committee must be:
    - Informed
    - Reasoned, and
    - Documented
  - The Committee Secretary must know how to frame the topic, the matters discussed, the documents reviewed and relied upon, the committee decision and the reasons supporting the decision
  - Poorly written minutes are a treasure trove for Plaintiffs' counsel
- ✓ Documents presented at meetings must be retained with the minutes
  - Failure to retain documents discussed or relied upon will make it hard to defend decisions taken at meeting

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Investment & Service Provider Monitoring

Monitoring requires periodic lookback at prior decisions not just investment performance and expenses

No "Auto Pilot"

Monitoring is labor/time intensive

Monitoring is qualitative as well as quantitative, e.g. look at policies and procedures applied to plan/investment management – proxy voting, best execution

Are service providers conforming to their contracts

NB Lack of monitoring most fertile ground for fiduciary risk

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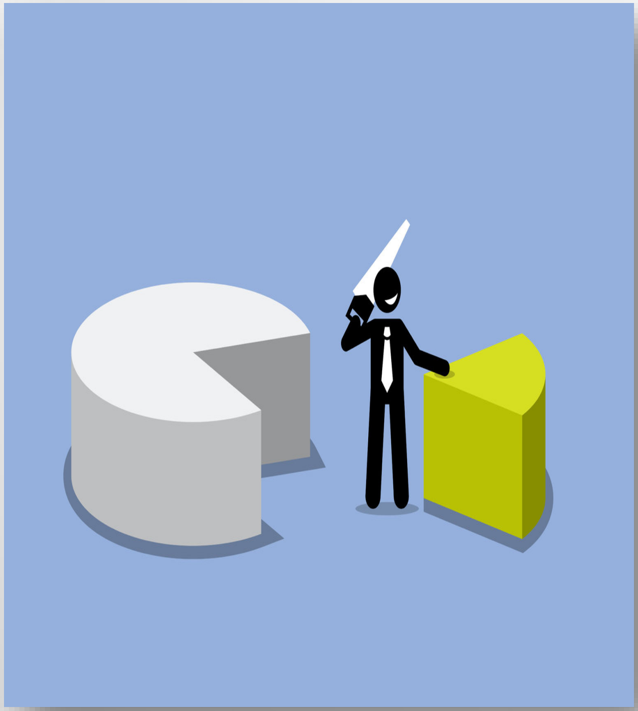
Reasonable Expenses

✓ Plan Fiduciaries must know the nature, source and rationale for every expense charged against plan assets

- A Plan may pay only “reasonable” expenses
- As a first step each expense must be itemized, linked to its source and explained
- Expenses must be consistent with regulation and service agreements
- Expenses must be justified based on the nature and quality of services and the needs of the plan

Revenue Sharing



- ✓ Beware "revenue sharing"
  - Revenue sharing is not per se imprudent, but if not properly managed breeds imprudence
  - Revenue sharing is generally derived from asset based charges which rise as assets grow, while the reasonable cost of services is more static
  - Must establish reasonable cost of services and monitor that revenue sharing does not allow service providers to receive excessive compensation

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Fee Benchmarking

- ✓ Beware reliance on fee benchmarking – there is no prudent substitute for periodic competitive bidding (RFP)

  - To validate particular expenses, plan fiduciaries should periodically submit all service contracts to competitive bidding

  - While fee benchmarking surveys/reporting provide an indication of reasonable cost, there is no guarantee that data relied upon was derived from prudent plan sponsors or plans with similar demographics

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"The Knowledge Gap-is There One?"

How Confident Are You Of Your Clients Knowledge Of Their Fiduciary And Plan Administration

Meaning of ERISA	Mutual Funds	Compensation to Record-keeper	Comingled Funds
Collective Trusts	Target Date Funds	Party in Interest	Summary Plan Description
Form 5500	Investment Committee as Named Fiduciary	Separately Managed Accounts	Interest Income Fund
Revenue Sharing	Select & Monitor Core Funds	Indirect Compensation	IPS Provisions

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Now we know there is a "Knowledge Gap," Why is that important to you?

01

Investment/Plan Committees need fiduciary training as a best practice

02

Investment advisors should deliver fiduciary training as a best practice

03

Reputation risk

04

Litigation risk

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What Fiduciary Training is Typical?

What else is Required?

Typical Training

- Fiduciary Roles & Responsibilities
- Applicable Laws
- Fund Selection
- Asset Allocation
- Need for IPS & Content
- Service Provider Selection & Monitoring
- Use of "Prudent Expert"
- Accounting for & Controlling Costs
- Monitoring of:
  - Investment Performance
  - Service Providers
  - All in Expenses

Required Additions

- Differences in:
  - Mutual funds
  - ETFs
  - Collective Trusts
  - Separate Accounts
  - GVAS
- Share Class Differences & Composition of Expense Ratio
- Capital Preservation Options
- What should be Monitored?
- Target Date Funds Construction & Benchmark
- Revenue Sharing:
  - Advantages
  - Disadvantages
- Difference Between:
  - Benchmarking & a Competitive Bid

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"Causation"

What it Means for Clients and Advisors

Q. If investments are imprudently selected and a loss is proven, is that enough to establish a right to damages?

A. No! The imprudence must be shown to have caused the loss.

Q. Who bears the burden of proof? The Plaintiffs who bring the claim? Or, the fiduciaries who selected imprudent investments?

A. Opinion is divided. The Supremes are asked to decide.

What does this all mean?

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Advisor Litigation Risk - Concepts to Consider!

- Co-Fiduciary Status
- Ignorant client
- Lack of Evidence of Procedural Prudence
- E&O Policy Proceeds
- Use of Exculpatory Contract Language

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Key Takeaways:-

- Be nimble – Actions are judged on facts and circumstances. These may vary from plan to plan. Court decisions and settlements provide fiduciary insights.
- Review and revamp fiduciary training
- Ensure that Plan Sponsors are properly documenting fiduciary decisions

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