# The Seven Core Principles Every Fiduciary Should Know and Follow

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**Mission:**

fi360 will help our clients gather, grow, and protect assets through better investment and business decision-making.

# Fiduciary Webinars & Certification Workshops

- In collaboration with Dimensional
- 4 webinars planned for 2015
- Workshops for firms that intend to achieve CEFEX fiduciary certification
- No charge to attend workshop
- Significantly reduces cost of CEFEX assessment
- Workshop dates in 2015:
  - May 28-29  Santa Monica, CA
  - October 15-16  Pittsburgh, PA
- E-mail Linda admin@cefex.org for brochure

CEFEX

CENTRE FOR FIDUCIARY EXCELLENCE

## Fiduciary Certification Workshops

**Why get CEFEX-certified?**

CEFEX is an independent global assessment and certification organization. It works closely with investment fiduciaries and industry experts to provide comprehensive assessment programs to improve risk management for institutional and retail investors.

- Advisory firms benefit from differentiation in an industry where clients are either confused by the fiduciary debate, afraid of fraud, or generally unaware.
- CEFEX certification gives advisory firms a unique distinction by helping to demonstrate their trustworthiness.
- It helps firms grow assets as it displays their commitment to clients and stakeholders.
- It helps manage risk by encouraging prudence and process, hence the avoidance of errors.
- Since risk is reduced, it can reduce professional liability insurance premiums.
- It fosters a culture of excellence and continuous improvement at the advisory firm.

**Read about CEFEX certification at www.cefex.org/advisor**

**The Fiduciary Certification Workshop**

An expert CEFEX Fiduciary Analyst conducts a practical overview of fiduciary best practices in a classroom setting with a group of advisory firm representatives. Each participant has access to a unique online questionnaire: "CEFEX Assessment of Fiduciary Excellence" (CAFÉ) for his/her firm. The Analyst will guide the participant through the completion of their CAFÉ.

**Sample Workshop Agenda Elements: 1.5 days:**

1. Introduction
2. Fiduciary Best Practices Overview
3. Fiduciary Best Practices Practical Review

   The CEFEX Analyst walks through specific fiduciary elements including: Service Agreement, Disclosures, Investment Policy Statement, Investment Due Diligence and Monitoring, Asset Allocation and Capital Market Assumptions, ERISA Safe Harbors, 3(38) Investment Manager Safe Harbor.

   The workshop participant will use the online CEFEX Assessment of Fiduciary Excellence (CAFÉ) to assess practices within his/her own firm.
4. Lunch
5. Enterprise Overview
6. Investment Analysis using the fi360 Investment Analyzer
7. How to leverage CEFEX certification with clients

**Day 2:** Private time between CEFEX Analyst and Advisory firm representative – for those who intend to pursue certification (30-45 minutes per advisor in scheduled timeslots)

# Overview

- Introduction to fiduciary duties
- The seven core fiduciary functions
- A four-step quality management process
- Conclusion and Q&A

# Who is a Fiduciary?

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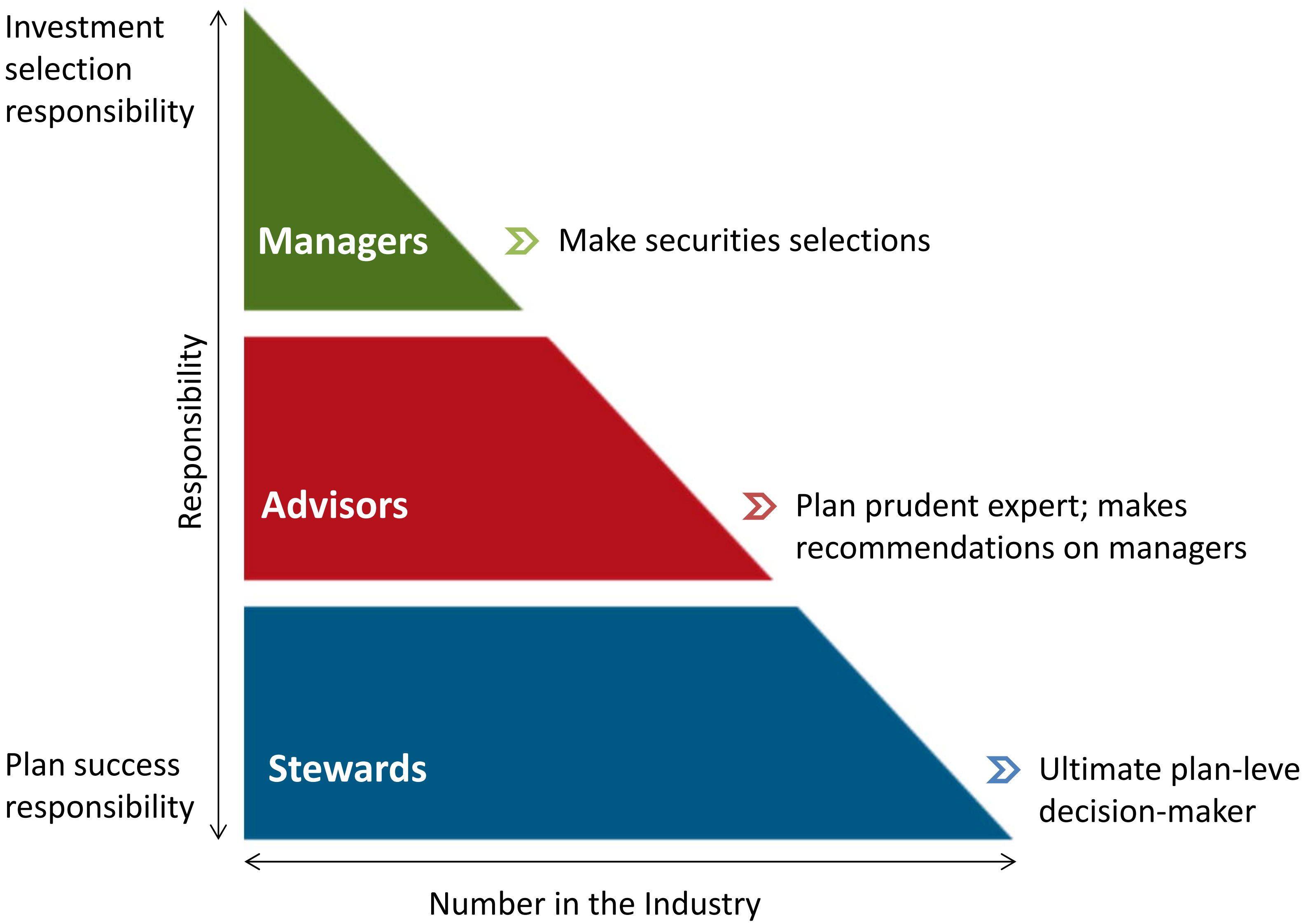
**Investment Fiduciary:**

– *Someone who is managing assets on behalf of others and stands in a special relationship of trust, confidence, and legal responsibility.*

# Roles and Responsibilities



# Fiduciary Roles in a 401(k) Plan

| Who serves as fiduciary? |
| --- |
| Employer:<br>– Named fiduciary<br>– Plan administrator<br>– Trustee |
| Investment committee:<br>– Owners<br>– Officers and key executives<br>– Board members |
| Service providers:<br>– Providing advice for a fee |

# Fiduciary Roles in a 401(k) Plan

## Who does not serve as a fiduciary?

Service providers:

- Brokers/sales reps who make "recommendations" or collect commissions
- Record-keepers
- Third-party administrators
- Custodians
- Attorneys
- Accountants

Employer:

- Plan sponsor in establishment, decisions to alter or amend a plan

# Fundamental Principles of Fiduciary Responsibility

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## Duty of Loyalty:

- Best interest of client
- Acting in good faith
- Managing conflicts in accordance with client best interest

## Duty of Care:

- Competence
- Demonstrating good judgment, knowledge and diligence
- Documentation

# Global Fiduciary Precepts

1. Know standards, laws, and trust provisions
2. Diversify assets
3. Prepare investment policy statement
4. Use “prudent experts” and document due diligence
5. Control and account for investment expenses
6. Monitor the activities of “prudent experts”
7. Avoid or manage conflicts of interest

# Precept # 1: Know Standards, Laws, and Trust Provisions

- Stewards, as fiduciaries, must understand the laws and documents that govern their actions.
- Professional advisors (i.e. attorneys and consultants) are helpful resources.

# Laws and Regulators

- Pension legislation:
  - Employee Retirement Income Security Act of 1974 (ERISA)
  - Pension Protection Act of 2006 (PPA)
- Regulatory agencies:
  - Department of Labor (DOL)
  - Internal Revenue Services (IRS)

# Role of Governing Documents

- Define roles and responsibilities
- Establish service requirements
- Set criteria for investment selection and monitoring
- Demonstrate procedural prudence

# Precept # 2: Diversify Assets

- Diversification of investments is required under ERISA in order to minimize large losses.
- Participant-directed plans must provide sufficient asset classes to enable adequate diversification.

# Defining the Investment Profile

# The Problem with Time Horizon in a DC Plan

Not all participants look the same: how do you manage so many profiles in one plan?

# Participant “User Error”

- “1/n” Phenomena
- Selecting only one option

# Precept #3: Prepare Investment Policy Statement (IPS)

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- The investment policy statement serves as the critical management tool to direct the activities of the investment process.
- Preparing and following a well-crafted IPS facilitates consistent decision-making, clarifies roles and responsibilities, and documents all investment processes.

# The Role of the IPS

- Serves as the “business plan”
- Addresses the management of each of the Global Fiduciary Precepts
- Sufficient detail for a competent third party to implement
- Not so detailed to require constant revisions and updates

# IPS Outline

- Executive Summary:
  - Identifying Information, Governing Law, Objectives, Safe Harbors
- Roles and Responsibilities:
  - Investment Committee, Advisors, Service Providers
- Asset Allocation and Rebalancing
- Due Diligence Procedures
- Monitoring Procedures:
  - Performance, Watch List, Costs, IPS Review
- Attachments:
  - Fund List, Fiduciaries

# Benefits of an IPS

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- Provides a paper trail to rely upon in the event of a legal challenge or dispute.
- Helps decision-making committee members, trustees and others evaluate decisions of their predecessors.
- Keeps investment process intact during market upheaval.

# Precept #4: Use "Prudent Experts" and Document Due Diligence

- Service providers must be selected using a consistent, prudent process.
- Service providers provide special expertise or capabilities to help stewards execute their fiduciary duties.
- Stewards may be protected under law when delegating responsibilities to qualified service providers.

# Service Provider Due Diligence

- Define service requirements
- Use RFP or RFI process
- Capabilities, costs, and security are key criteria
- Require 408(b)(2) type disclosure
- Documentation is essential

# Choosing Investment Managers: Suggested Minimum Criteria

| fi360 Recommended Due Diligence Screens | |
|---|---|
| 1 | **Regulatory Oversight**<br>Threshold: Managed by a bank, insurance company, registered investment company, or RIA |
| 2 | **Minimum track record**<br>Threshold: At  least three years history |
| 3 | **Stability of the organization**<br>Threshold: Manager tenure of at least two years |
| 4 | **Assets in the product**<br>Threshold: At least $75 million |
| 5 | **Holdings consistent with style**<br>Threshold: At least 80% |
| 6 | **Correlation to style or peer group**<br>Threshold: Consistent with asset class being implemented |
| 7 | **Expense ratios/fees**<br>Threshold: Above $75^{th}$ percentile of peer group |
| 8 | **Performance relative to assumed risk**<br>Threshold: Compare Alpha and Sharp Ratio to peer group median |
| 9 | **Performance relative to a peer group**<br>Threshold: Compare year performance to peer group median |

# Caveat: Chasing Hot Managers

- Chasing top quartile performance
- For the five-year period  2009 – 2013
  - Universe of 6,348 funds
  - 29 (0.4%) funds survived

Data source: Morningstar Large, Mid, and Small equity funds and the fi360 Toolkit.
As of December 31, 2013

# Precept #5: Control and Account for Investment Expenses

- Stewards must evaluate and account for investment related fees, compensation, and other plan expenses.
- Expenses must be reasonable considering the scope of services provided.

# Investment Expenses

- Investment Manager – Fees and/or annual fund expenses
- Trading or processing costs (i.e., commissions, soft dollars, directed brokerage, and 12b-1 fees)
- Custodial charges – custodial fees and transaction charges
- Consulting, recordkeeping, and administrative costs

# Investment Manager Compensation

- Are investment manager fees necessary and reasonable given:
  - asset class
  - account size
  - investment vehicle
- No obligation to select lowest cost providers

# Precept #6: Monitor the Activities of "Prudent Experts"

- ERISA requires stewards to monitor the activities and performance of all service providers.
- The monitoring process is similar to the due diligence process used to select service providers.
- Monitoring is ongoing and requires corrective action when changes are necessary.

# Scope of Monitoring

- Investment performance
- Service providers and “Prudent Experts”
- Self-monitoring

# Monitoring Criteria

- Conformance with governing documents
- Conformance with contracts
- Performance
- Qualitative factors
- Fees and expenses
- Fiduciary policies and procedures

# Frequency of Monitoring

- Recommended schedule:
  - **Monthly** – review custodial statements
  - **Quarterly** – review overall portfolio and individual investment performance
  - **Annually** – review IPS, service providers, and your own fiduciary performance
  - **Every three years** – revisit vendor contracts
  - **Impromptu –** reviews as circumstances dictate

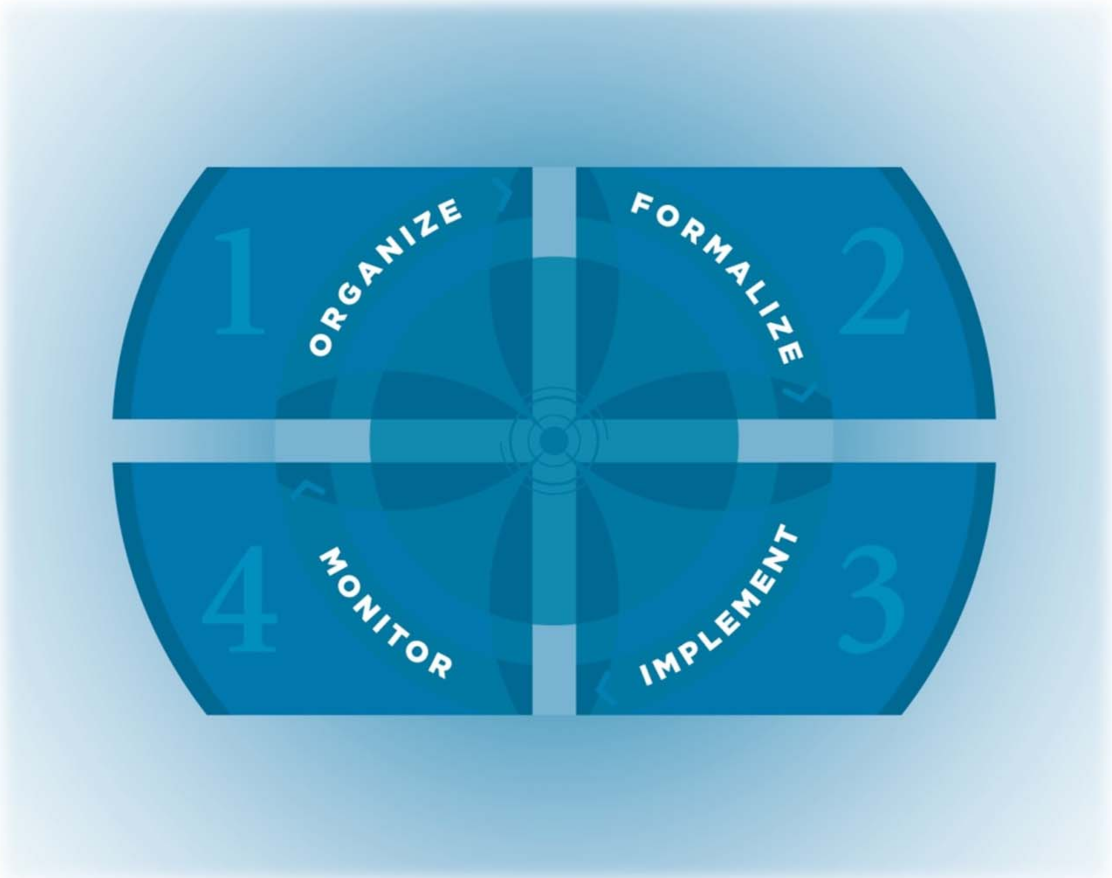
# Precept #7: Avoid or Manage Conflicts of Interest

- Fiduciary duty of loyalty requires stewards to avoid conflicts of interest and prohibited transactions.
- Decisions must be for sole or exclusive benefit of plan participants and their beneficiaries.

# Prohibited Transactions and Parties-in-Interest

- Prohibited transaction rules serve to prevent interested parties from using plan assets for their own benefit.
- Parties-in-interest include the plan sponsor, fiduciaries, service providers, corporate officers and others.
- Fiduciaries are not permitted to have conflicts or to benefit themselves or anyone else other than plan participants and their beneficiaries absent a prohibited transaction exemption.
- Prohibited transaction exemptions allow parties-in-interest to receive reasonable compensation for acceptable services.

# The Fiduciary Quality Management System (FQMS)



# Step 1 - Organize

- Know and follow the rules
- Understand and acknowledge roles
- Avoid conflicts of interest
- Protect plan assets

# Step 2 - Formalize

- Analyze plan data
- Work through the hierarchy of investment decisions
- Document strategy in investment policy statement

# Step 3 - Implement

- Due diligence
- ERISA Safe Harbors
- Documentation

# Step 4 - Monitor

- Quantitative and qualitative reviews
- Fees and expenses
- Fiduciary reviews

# Q&A & Reminders

- Q&A – Enter your questions electronically into the GoTo Meeting interface.

- CE for fi360 –AIF® or AIFA® designees will receive a follow up email with instructions for self-reporting CE
- CE for CFP Board – fi360 will report CE for CFP® certificants directly

- Upcoming learning opportunities – stay tuned for announcements of upcoming webinars:
  - April 22 – on the investment policy statement
  - TBD – Explaining the DOL's fiduciary rule proposal