401 K Plan Sponsor Responsibilities

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The delivery of a 401K plan requires coordination among the plan sponsor, advisor, administrator and the custodian for the securities offered. Involvement may include being named as trustee for your employer, working with employees in the human resource area, coordinating administration for the plan and the work many of our members provide as investment advisors. These relationships are construed as being a fiduciary to the plan and thus held to a higher standard for compliance and due diligence.

In light of the erosion of confidence we have had with our financial institutions over the past several years, the issue of plan sponsor responsibilities has taken on highlighted interest. There is increased interest among plan sponsors looking for guidance on what is expected of them. The need to review the plan and develop a process to assure confidence when serving as a trustee have raised the bar for those persons deemed to be fiduciaries. There are several questions a plan sponsor can raise:

- Are we confident that our fund platform provides good performance at a reasonable cost?
- What is "good performance"?
- Are we limited with respect to fiduciary liability that appears to be incumbent with the offering of an employee benefit plan?
- Are we giving our employees enough information and education to enable them to make investment choices they are comfortable with?
- How do we review the plan to foresee potential problems with independent fund managers and / or style shift among stated objectives?

The Investment Policy Statement

Institutional investors, foundation stewards and large plan sponsors have adopted the process of creating an investment policy statement (IPS) as a matter of practice. This methodology has been established to define the responsibilities of investment advisors, managers and custodian in addition to citing the written plan objectives for the sponsor. The investment policy statement also may define the spectrum of investments to be offered, standards for measuring performance and the range of expenses to consider for prudent plan management. The IPS is gaining popularity among small plan sponsors. Smaller plans with less than a million dollars of assets are adopting this strategy.

An investment policy statement can define who may serve on the investment committee for the plan. The role of the investment committee would serve to monitor plan performance, offer suggestions to the trustees for fund changes and coordinate a periodic vendor review for platform selection, pricing and related services offered through the vendor and administrative relationships. This committee may include the plan trustee(s), advisor, chief financial officer, human resource personnel or other interested parties representing the sponsor.

Review Cost, Performance and Value

All employers should review their plan periodically with respect to performance, costs and the perceived value of the current plan design and platform. A recent review for a client uncovered "C" shares in a mutual fund platform among the mutual funds offered in a 401K plan. This share class is designed to provide an annual fee to the investment advisor and may contain a higher investment management fee for the fund offered as disclosed in the prospectus. The review suggested that as many as 4 alternate vendors provided a platform of funds with better performance and lower expenses. Many platforms offer funds designated as "A" or "R" share classes. These may be offered at net asset value from the plan vendor. However, fund management costs are an important factor in demonstrating the employees' cost and fund performance is usually reflected net of the fund management expense disclosed.

Most 401K retirement plans today are accessed through a vendor website for participant interaction. The vendor provides a website for access, and the site contains tools for participant use to access fund information, engage changes and provide the ability to self direct their account balances. The vendor also provides a master platform of funds permitted to be offered for the participants by the plan sponsor.

This gatekeeper function and the selection of funds on the platform are the basis of what is provided for the participants and is usually selected by the plan advisor or an investment committee as noted above. The investment committee is responsible for monitoring the funds offered. However, these platforms change. The dynamics of a plan may change. A two million dollar plan today may be a five million dollar plan tomorrow. Pricing changes with respect to the plan size for a vendor. It is incumbent on the plan sponsor to review the vendor at least every three years to support confidence that the plan is priced correctly and the resources available to plan participants are current.

Performance is difficult to measure properly. Although most mutual funds and vendors publish mutual fund performance,

401 K Plan continued

the question should be not so much as how did we do in the last quarter, or previous 12 months, but how did that manager do relative to their peer group for the same type of fund? How is the fund ranked by independent third party resources? Clarifying these parameters and using them as a guide to evaluate performance may be beneficial to plan sponsors and serve to be included in the investment policy statement as a standard to be agreed upon by an investment committee empowered by the policy statement.

The value of the plan can be measured by the participation and the average deferral rate for participants. Value can also be measured by how often people use the internet to manage their account balances and seek information from website tools to assist them with financial planning projections or use information for the plan offered. Most plan sponsors track this utilization and provide this information during an annual plan review.

It is important to recognize that investing in mutual funds involves risk, including possible loss of principal. Investments in specialized industry sectors have additional risks, which are outlined in the prospectus.

Monitor the Plan

In the retirement plan area, the best offense is a great defense. Yes, it is important to try to put together a terrific platform with top performing funds, as measured by the relevant criteria established by an investment committee. However, the process that defines how and when we review the plan and documentation will provide a strong defense for the liability of financial responsibility inherent as a plan sponsor.

The process of tracking benchmarks is important. Recently a mutual fund platform was reviewed using a quarterly tracking for each fund manager within their peer group for managers of similar fund types. The peer group performance was determined to be measured for the prior three years ended December 31, 2009. The ranking had deteriorated from the top quartile to the bottom two quartiles over a period of two years. This deterioration enabled the plan sponsor to recognize that this was a cause to change the fund or at minimum put it on a watch list for the next quarterly review. A responsibility of an investment committee is to determine what benchmarks are appropriate and how often they are reviewed. When comparing fund data with benchmarks, determining the range of acceptable limits is one the most important committee decisions to consider. This methodology and the process is an important step toward providing defensible plan management and investment stewardship.

Investment Information or Investment Advice

Section 404C of the Employees Retirement Income Security Act provides clear guidance for plan sponsors on the issue of employee education. Most plan advisors and vendor representatives cover the basic plan concepts of risk tolerance, asset allocation, rebalancing, dollar cost averaging and periodic review. However, many employees are quietly confused with what choices to make and why. The enrollment process should review these platform fund choices available and the rationale for making alternate suggestions. However there is a clear line between advising what choices to make and what choices are available. A plan fiduciary is not responsible for telling a participant what choices to make as much as providing enough information to suggest what choices are available.

Fiduciary Warranty

Several plan sponsors offer fiduciary warranties. This assurance was developed to assure the plan sponsor that in the event a participant presents a grievance with respect to the fund platform and related performance the vendor will provide legal counsel. The foundation for the warranty is the vendors' internal due diligence process to determine how fund managers are placed on the platform and the assortment of funds that are available to provide adequate choice for the various investor risk profiles that participants may have. Additionally, a vendor may provide a fund performance assessment for qualitative and quantitative measurement for clients to review annually. Whereas, some vendors provide the warranty directly, others subcontract an independent resource to perform this diagnostic testing to support their warranty offer.

In conclusion, creating an investment policy statement, defining the role and parameters for decision making within an investment committee, and creating a process to review a vendor platform will support sponsor confidence. Working with a plan advisor that understands this process is critical. These concepts define plan governance and suggest that the liability inherent with plan involvement will be managed effectively.

Additional questions may be directed to Steven Leshner, ChFC, CLU, AIF, MBA, AEP, The Commonwealth Investment Management Group, LLC, 115 West Avenue, Suite 116, Jenkintown, Pennsylvania 19046 Securities offered through LPL Financial, member FINRA, SIPC.

Additional Resources

"Meeting Your Fiduciary Responsibilities", published be the U.S. Department of Labor, Employee Benefits Security

continued on page 16

401 K Plan continued

Administration, October 2008 www.dol.gov/ebsa

"Evaluating Retirement Plan Advisors: A Dynamic Guide to Help Plan Sponsors Fulfill Their Fiduciary Duty and Avoid Liability", by Philip Chiricotti, Center for Due Diligence (CFDD) www.TheCFDD.com

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