Optimizing 401(k) Plan Performance and Management of Fiduciary Liability

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Parkinson’s Law (1955)
Work expands so as to fill the time available for its completion

Parkinson’s Law of Triviality (1957)
The time spent on any item of the agenda will be in inverse proportion to the sum (and the complexity of the issue) involved.

C. Northcote Parkinson
Managing Risk Can Be Easy
Knowledge & Awareness is the Key

The “Radium Girls”
Reasons Fiduciary Blind Spots Exist

1. Many Plan Sponsors and the Individuals Serving on Plan Committees (a.k.a. Plan Fiduciaries)
   – Don’t realize they are THE Fiduciary for their plan
   – Aren’t aware of the extent of their personal financial liability
   – Underestimate the full scope of their fiduciary responsibilities
   – Don’t understand the true nature of the legal relationship with their plan’s service providers

2. Financial industry has created needlessly complex and opaque business models and fee structures

3. Lack of in-house fiduciary compliance and governance expertise
The Biggest Reason

They’re too busy running their business.
The Fiduciary Opportunity

1. Reduce costs for Basic Plan Services* by 20% - 60%

2. Improve plan quality, services, and participant results

3. Properly manage and isolate fiduciary risk

4. Minimize personal and corporate financial liability exposure

* Basic Plan Services = custody, recordkeeping, third party plan administration, employee education, and plan investment options
1) Issues and Challenges for Plan Fiduciaries

2) Fiduciary Blind Spots

3) The Evolution of Fiduciary Risk

4) Protecting Plan Fiduciaries

5) Fee Disclosure Compliance

6) Improving Plan Participant Results

7) Case Studies
Issues and Challenges for Plan Fiduciaries

Understanding Fiduciary Duty
Defining Plan Fiduciaries

- Makes or influences decisions regarding plan management, administration or disposition of assets
- Hires, fires, or decides to retain service providers
- Appoints employees to serve as a trustee or member of a plan committee
- Serves as a trustee or member of a plan committee

[ERISA §3(21)]

Generally, the act of selecting plan service providers is an exercise of discretion over the management or administration of the plan or its assets. Thus the person selecting the service provider is a fiduciary within the meaning of ERISA and subject to ERISA’s fiduciary standards.

[Batchelor v. Oak Hill Medical Group, 870 F.2d 1446 (9th Cir. 1989)]
Risks of Fiduciary Liability

- Legal and financial penalties for the corporation
- Trustees’ personal assets are exposed to financial penalty
- Governmental enforcement and civil litigation
- Liability for acts and omissions
- Regardless of whether these errors result from one’s own actions or the actions of others

Most Plan Sponsors get sued for what they don’t do, not for what they do.

- Fred Reish (Partner at Drinker Biddle & Reath LLP and Noted ERISA Fiduciary Expert)
Incomplete Understanding of Fiduciary Duty

• Act prudently and in good faith
• Delegate to an established provider
• File the annual 5500
• Distribute the Summary Annual Report
• Manage eligibility
• Make deposits in a timely manner
The “Prudent Man Rule” Isn’t Good Enough for ERISA Fiduciaries

Fiduciary duties under ERISA “are the highest known to law.”
[Donovan v Bierwirth, 680 F2d 263272 (2nd Cir 1982)]

“Under ERISA the Fiduciary is held to the so-called prudent expert rule even if he lacks the capabilities required to carry out his fiduciary duties.”
[3 Donovan v Mazzola, 716 F. 2d 1226, 4 E.B.C. 1865 (9th Circuit 1983)]

. . . ERISA’s prudence test is not that of a prudent lay person but rather that of a prudent fiduciary with experience dealing with a similar enterprise
[Marshall v Snyder, 1E.B.C. 1878 (E.D.N.Y. 1979); 404(a)(1)(B)]

Plan Fiduciaries & Trustee Committee Members must be as prudent as the average fiduciary expert, not the average person!
Global Fiduciary Precepts

1. Know standards, laws and trust provisions governing Plan
2. Diversify assets to specific risk return profile
3. Prepare investment policy statement ("IPS")
4. Use prudent experts and document due diligence
5. Control and account for investment expenses
6. Monitor and supervise activities of the prudent experts
7. Avoid conflicts of interest and prohibited transactions

[Source: Fiduciary360 and the Foundation for Fiduciary Studies]
Established Standards and Practices

**Prudent Practices Handbook**

- **Defines a Global Fiduciary Standard of Excellence**
  - 22 practices prescribed by law
  - 82 criteria define and support the practices
  - Fully substantiated by regulation and case law
  - Technical review by AICPA

- **Addresses many of the legal and ethical requirements applicable to stewards and plan fiduciaries**
  - Represents the minimum process and basic standards prescribed by law

- **Consistent with ISO 9000**
Established Standards and Practices

Prudent Practices Handbook

PERIODIC TABLE of GLOBAL FIDUCIARY PRACTICES for INVESTMENT ADVISORS
Step 1—Organize

- **Practice 1.2**
  - Investments and investment services under the oversight of the Investment Steward are consistent with applicable governing documents.

- **Practice 1.3**
  - The roles and responsibilities of all involved parties (fiduciaries and non-fiduciaries) are defined, documented and acknowledged.

- **Practice 1.4**
  - The Investment Steward identifies conflicts of interest and addresses conflicts in a manner consistent with the duty of loyalty.

- **Practice 1.5**
  - The Investment Steward requires agreements with service providers to be in writing and consistent with fiduciary standards of care.
Step 2—*Formalize*

- **Practice 2.4**  
  - Selected asset classes are consistent with the portfolio’s time horizon and risk and return objectives.

- **Practice 2.5**  
  - Selected asset classes are consistent with implementation and monitoring constraints.

- **Practice 2.6**  
  - The investment policy statement contains sufficient detail to define, implement, and monitor the portfolio’s investment strategy.
Step 3—Implement

• **Practice 3.1**
  – A reasonable due diligence process is followed to select each service provider in a manner consistent with obligations of care.

• **Practice 3.2**
  – When statutory or regulatory investment safe harbors are elected, each investment strategy is implemented in compliance with the applicable provisions.

• **Practice 3.3**
  – Decisions regarding investment strategies and types of investments are documented and made in accordance with fiduciary obligations of care.
Step 4—Monitor

• **Practice 4.2**
  – Periodic reviews are made of qualitative and/or organizational changes of Investment Advisors, Investment Managers, and other service providers.

• **Practice 4.4**
  – Periodic reviews are conducted to ensure that investment-related fees, compensation, and expenses are fair and reasonable for the services provided.

• **Practice 4.5**
  – There is a process to periodically review the Steward’s effectiveness in meeting its fiduciary responsibilities.
The Fallacy of Delegation

If he lacks the expertise and capabilities required to carry out his fiduciary duties, the plan fiduciary “must engage experts who have the requisite skill, knowledge and experience needed by the plan.”

[3 Donovan v Mazzola, 716 F. 2d 1226, 4 E.B.C. 1865 (9th Circuit 1983)]

Fundamental duties which cannot ever be delegated include “surveillance and oversight” and the “avoidance of conflicts of interest” in protecting the interests of plan participants

[Leigh v Engle F 2nd 113 (7th Cir 1984), Mertens v Hewitt Assoc., 508 U.S 248, 251-52, 113 S. Ct 2063 124 L.Ed.2d 161 (1993)]

Co-fiduciary liability
Plan Fiduciaries can be held liable for fiduciary breaches committed by other named or unnamed fiduciaries [ERISA ‘405(a)]
Ignorance is Not Bliss Under ERISA

Plan Sponsors and **THE INDIVIDUALS SERVING ON THE TRUSTEE COMMITTEE** can be held liable and **PERSONALLY FINANCIALLY RESPONSIBLE** for violating or allowing others to violate ERISA §404(a)’s “Exclusive Benefit and Prudence Provisions” or ERISA §406’s “Prohibited Transactions or Self-Dealing Provisions” regardless of knowledge, intent or whether the plan was actually harmed or not.
Fiduciary Blind Spots

- Fees
- Conflicts of Interest
- Liability
Blind Spot 1: FEES

Governance and Oversight Responsibilities

• **Identify** the services rendered and service providers being compensated from plan assets;

• **Document** the fees and expenses charged to and extracted from the plan and participant accounts;

• **Determine** if the fee being paid to each service provider is reasonable for the services being delivered;

• **Monitor** and document plan fees and *service provider compensation* to assure fees are and continue to be reasonable as plan assets increase.

[ERISA 404(a); ERISA 408(b)(2); ERISA 406(a); UPIA 7; DOL Reg. 2550.408b-2(d)]
Blind Spot 1: FEES

Perception vs Reality

• 60%-70% of plan participants think their 401(k) is free

• 30% of senior finance and HR executives think the 401(k) is free

• 49% don’t know how to justify plan fees relative to value, but...
  • 79% intend to evaluate administration fees
  • 64% plan to evaluate investment expenses

[Koski Research, survey conducted for Charles Schwab, 2011]

• As a result, most 401(k) plans are paying fees 20%-60% higher than necessary for the services actually being received
### Blind Spot 1: FEES

**Internal Mutual Fund Expenses**

**Not All S&P 500 Funds are Created Equal**

<table>
<thead>
<tr>
<th>Fund Name</th>
<th>Expense Ratio</th>
<th>Annual Cost per $1MM</th>
</tr>
</thead>
<tbody>
<tr>
<td>Munder Index 500 (R Shares)</td>
<td>1.16%</td>
<td>$11,600</td>
</tr>
<tr>
<td>Nationwide S&amp;P 500 Index (R2 Shares)</td>
<td>0.93%</td>
<td>$9,300</td>
</tr>
<tr>
<td>Principal LargeCap S&amp;P 500 Index (R5 Shares)</td>
<td>0.42%</td>
<td>$4,200</td>
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<tr>
<td>Fidelity Spartan 500 Index (Advantage Shrs)</td>
<td>0.07%</td>
<td>$700</td>
</tr>
<tr>
<td>Vanguard 500 Index (Admiral Shares)</td>
<td>0.05%</td>
<td>$500</td>
</tr>
</tbody>
</table>
# Blind Spot 1: FEES

Revenue Sharing—Indirect Fees and Compensation

Example: EuroPacific Fund offered by American Funds

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>Management Fee</td>
<td>0.43%</td>
<td>0.43%</td>
<td>0.43%</td>
<td>0.43%</td>
<td>0.43%</td>
<td>0.43%</td>
<td>0.43%</td>
</tr>
<tr>
<td>Distribution &amp; 12b-1 Fees (compensation paid to broker, agent, or plan provider)</td>
<td>0.24%</td>
<td>1.00%</td>
<td>0.75%</td>
<td>0.50%</td>
<td>0.25%</td>
<td>none</td>
<td>none</td>
</tr>
<tr>
<td>Sub-TA and Other Fees (compensation paid to recordkeeper or TPA)</td>
<td>0.18%</td>
<td>0.21%</td>
<td>0.48%</td>
<td>0.22%</td>
<td>0.18%</td>
<td>0.13%</td>
<td>0.09%</td>
</tr>
<tr>
<td>Total Internal Expense (fund performance reported net of fees)</td>
<td><strong>0.85%</strong></td>
<td><strong>1.64%</strong></td>
<td><strong>1.66%</strong></td>
<td><strong>1.15%</strong></td>
<td><strong>0.86%</strong></td>
<td><strong>0.56%</strong></td>
<td><strong>0.52%</strong></td>
</tr>
<tr>
<td>Annual Cost per $1MM (fund performance reported net of fees)</td>
<td><strong>$8,500</strong></td>
<td><strong>$16,400</strong></td>
<td><strong>$16,600</strong></td>
<td><strong>$11,500</strong></td>
<td><strong>$8,600</strong></td>
<td><strong>$5,600</strong></td>
<td><strong>$5,200</strong></td>
</tr>
</tbody>
</table>
Blind Spot 1: FEES

Percent of Asset Fee Structures

- Increase in Actual Fees Collected as Plan Assets Increase When Charging a 1% Fee
- $$$ Windfall Received by Plan Provider $$$
- Actual Increase in the Cost of Plan Operations as Plan Assets Increase
Blind Spot 2: CONFLICTS OF INTEREST

Governance and Oversight Responsibilities

• **Identify** conflicts of interest (or potential conflicts) that may impact the management of the plan;

• **Evaluate** those conflicts and the impact they may have on the plan and its participants;

• **Determine** whether the conflicts will adversely affect the plan;

• **Consider** protections that would protect the plan and participants from any potential adverse affects;

• **Take action** to address conflicts that adversely affect the welfare of the plan and its participants.

[The Fiduciary Duty to Avoid Conflicts of Interest in Selecting Plan Service Providers, C. Frederick Reish and Joseph C. Faucher, February 2009]
The Suitability Standard of Care

vs

The Fiduciary Standard of Care
### 90% of Industry

[cerulli Associates, 2010]

**Perception does not match reality**

- 54% - 75% of investors believe that stockbrokers have a fiduciary responsibility to act in the investors’ best interest.
- 47% of investors are unaware that stockbrokers are not required to disclose all conflicts of interest.

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**Suitability Standard of Care**  
**(Rules Based)**

<table>
<thead>
<tr>
<th>Sales standard developed by industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Permitted to act in a manner and place their self interests ahead of client’s</td>
</tr>
<tr>
<td>• Commission based compensation</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>General investment advice incidental to sales transaction</th>
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<tbody>
<tr>
<td>Brokers</td>
</tr>
<tr>
<td>Agents</td>
</tr>
<tr>
<td>Registered Representatives</td>
</tr>
</tbody>
</table>

| Work for and represent *their firm* |

<table>
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<th>Recommendations must be suitable based upon the clients</th>
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<tbody>
<tr>
<td>• Age</td>
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<tr>
<td>• Time horizon</td>
</tr>
<tr>
<td>• Risk tolerance</td>
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<tr>
<td>• Investment experience</td>
</tr>
</tbody>
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| **Suitability Standard of Care**  
| (Rules Based) |
| Sales standard developed by industry  
| • Permitted to act in a manner and place their self interests ahead of client’s  
| • Commission based compensation |
| General investment advice incidental to sales transaction  
|   Brokers  
|   Agents  
|   Registered Representatives |
| Work for and represent **their firm** |
| Recommendations must be suitable based upon the clients  
| • Age  
| • Time horizon  
| • Risk tolerance  
| • Investment experience |

| **Fiduciary Standard of Care**  
| (Ethics Based) |
| Same as Doctors, Attorneys & CPAs  
| • Client’s best interests always first. **Period!**  
| • Fee-based compensation |
| Specific and formal investment advice  
| • Registered Investment Advisors |
| Work for and represent **the client** |
| In addition to suitability standard, RIA’s are legally obligated to  
| • Place client’s best interests and welfare ahead of all other considerations  
| • Assume liability for recommendations  
| • Disclose all conflicts of interest  
| • Resolve all conflicts in favor of the client  
| • Control and account for fees  
| • Disclose compensation |
Blind Spot 3: LIABILITY

Governance and Oversight Responsibilities

• Trustee(s) shall have the exclusive authority and discretion to manage and control the assets of the plan. [ERISA 403(a)]

• Trustee(s) must act in the sole and exclusive benefit of plan participants

• Even after delegating to outside experts, trustees retain the ultimate responsibility and liability for plan oversight and operations
Blind Spot 3: LIABILITY
Perception vs Reality

Fiduciary Concerns for Every Trustee

- Non-fiduciary fiduciaries (a.k.a. Phantom Fiduciaries)
  - Legal *fine* print and escape clauses greatly limits responsibility and drastically restricts the scope of provider’s services so as to effectively eliminate *their* fiduciary liability when servicing the 401(k) plan.

- Fiduciary marketing
  - Warranties
  - Turnkey 3(38) and 3(21) solutions

- Most Plan Sponsors and Trustee Committee members unknowingly retain liability they think they’ve delegated.
Blind Spot 3: LIABILITY

Fiduciary Warranties

Let’s look at the not so fine print.

Magnuson-Moss Warranty Act of 1975
Blind Spot 3: LIABILITY

Fiduciary Warranties

While we are not acting as a fiduciary for the Plan in selecting and monitoring investment options in our offering, we stand behind our products.

For our warranty to apply, the investment options offered for Plan participants must, at a minimum and at all time, include all nine Lifecycle funds or all five lifestyle funds, plus at least one fund from each of the following classes of funds offered by <redacted>.

Our warranty does not relieve the Plan fiduciaries of their responsibilities. With respect to the investments we make available, the Plan fiduciaries remain responsible for the following:

- Review our investment selection and monitoring practices and, if approved, adopt them as part of the due diligence process for the selection of investment alternatives for the Plan
Our Fiduciary Standards Warranty does not extend to claims based on the needs of, or suitability for, any individual participant(s), but instead covers the general prudence of investment options for long-term investing.

Nor does our Fiduciary Standards Warranty extend to claims that any expenses paid directly or indirectly by the Plan are reasonable.

Our Fiduciary Standards Warranty extends only to loss, damage, expenses or liabilities . . . under ERISA as a result of a breach of fiduciary duty by Plan fiduciaries at the Plan sponsor . . . **Subject to** the conditions stated above and your performance of the fiduciary responsibilities stated above.
Blind Spot 3: LIABILITY

401(k) Vendors’ Legal Positions on Fiduciary Liability
Blind Spot 3: LIABILITY
401(k) Vendors’ Legal Positions on Fiduciary Liability

Tussey v. ABB, Fidelity, et al
Fidelity argued that all “Counts should be dismissed against Fidelity because Fidelity defendants have no fiduciary status relevant to the plaintiffs’ claims” in regards to Fidelity’s recommendation that Fidelity mutual funds be used in the plan, because Fidelity is merely a “directed trustee” who simply followed the orders of the plan sponsor and trustee committee members.

Haddock v Nationwide Life
Nationwide claimed in court documents that “If Nationwide Life is found to have violated ERISA by arranging for, receiving, and retaining payments from funds...then the Trustees are reckless and also at fault to the extent the Plans suffered harm..., because the Trustees had the ultimate responsibility for managing the Plan, and investing Plan assets.” They even asked that the trustees pay for Nationwide’s fiduciary breaches.

Charters v John Hancock
John Hancock countersued their client (Charters) for breach of fiduciary duty, monetary contribution and indemnity for being negligent in hiring John Hancock in the first place. John Hancock also claimed not to be a fiduciary.

[Will the Real Fiduciary Please Stand Up, Unified Trust Company, N.A., 2012]
Guess Who’s Left Holding the Bag
The Evolution of Fiduciary Risk

- Examples
- Key Court Rulings
Fiduciary Risk is Real

Look at the Numbers

• 2011 Dept. of Labor 401(k) enforcement initiative
  • 2x increase in civil and 8x increase in criminal investigations since 1996
  • 3,472 civil investigations with 75% success rate
  • 255 civil cases referred to litigation (144 filed)
  • $1.39 billion in monetary results (includes $766MM in Prohibited Transactions recovered)
  • 302 criminal investigations closed with 129 indictments and 75 pleas/convictions

• ~100 new investigators hired by DOL in 2012/2013

• More than 90% of claims are filed by plan participants (employees)

[Dept. of Labor, November 2010; and North American Professional Liability Ins]
# Real Life Fiduciary Breaches

## The Problem

**CPA** firm hired by Plan failed to complete 5500 Audit 2 years in a row.

**Broker** recommended replacing an investment option with one that turned out to be less profitable.

**Two employees** approaching retirement discovered they never enrolled in the company’s 401(k) Plan.

**Recordkeeper and third party administrator** improperly delayed executing participant buy-sell orders and transferring fund balances.

**Small 401(k) Plan** lost $775,000 in an investment fraud perpetrated by their financial representative.

## Fiduciary Concern

**Responsibility and Liability**

- **Plan Management**
- **Investment Decisions**
- **Employee Communications**
- **Service Provider Selection, Oversight, and Due Diligence**

## Penalty Paid by Employer

- **$100,000 fine** negotiated down to **$10,000**
- **$500,000 in damages** plus **$358,000 in defense costs**
- **$378,000 settlement** plus over **$200,000 in defense costs**
- **$1,000,000 in damages for lost investment earnings** plus **$250,000 in defense costs**
- **$775,000 plus lost interest and opportunity costs. (DOL lawsuit underway)**
LaRue v. DeWolff

• U.S. Supreme Court
  • Ruling issued, February 20, 2008

• Fiduciary breach triggered by clerical error which cost LaRue $150,000

• The Court provided individual plan participants with legal standing to sue their employer and seek financial restitution for losses incurred resulting from an employer’s fiduciary breach
Tibble v. Edison International

- U.S. District Court for the Central District of California
  - July 2010

- Participants alleged that the Plan Fiduciaries breached their fiduciary duty by selecting retail share classes rather than less expensive institutional share classes

- Court was troubled by fact that the Plan Fiduciaries \textit{never asked} if lower cost share classes were available or if the minimum investment thresholds for institutional share classes could be waived
Tussey v. ABB, Inc, Fidelity Trust, and Fidelity Management, Et Al

- U.S. District Court Western District of Missouri Central Division
  - Decision filed, March 31, 2012 (Class action lawsuit originally filed in 2007)

- Alleged that the Plan Fiduciaries failed to discharge their fiduciary obligations by not properly documenting and monitoring Fidelity’s fees

- ABB, Inc., the ABB pension and benefits committees, and the individuals serving on these committees (collectively “Plan Fiduciaries”) which found them **jointly and severally liable for $35.2 million** in damages for violations of their fiduciary duty under ERISA
  - Fidelity was liable for $1.7MM in lost income related to float income it retained
Protecting Plan Fiduciaries

- Process
- Documentation
- Outsource
- Certification
Three Options for Plan Fiduciaries

**Avoid the risk** ➔ **Terminate the Plan**

**Ignore the risk** ➔ **Hope for the best**

**Manage the risk** ➔ **Document procedural prudence & compliance**

(Delegating certain functions to an independent professional ERISA fiduciary can help)
Two Levels of Plan Services

**Basic Plan Services**

- Administration *(directed non-fiduciary TPA)*
- Recordkeeping
- Custody
- Trustee services *(directed non-fiduciary)*
- Investments
- Group meetings
- Participant education *(generic and non-fiduciary)*
- Do-it-yourself participant and trustee resources

**ERISA Fiduciary Services**

- Administrative Services Fiduciary
  - Accepts transfer of fiduciary responsibility and liability for daily Plan operations from Plan Sponsor and payroll/HR staff
  - ERISA §3(16) plan administrator
- Participant Investment Advisor
  - Individualized personal investment advice
  - ERISA §3(21) investment advisor
  - CFP® personal financial planning
- Plan Investment Manager
  - Formal discretionary investment advisory services
  - ERISA §3(38) investment manager
- Fiduciary Governance & Compliance
  - Assumes liability for assuring proper discharge and documentation of fiduciary duty
  - Responsible for assembly, coordination and oversight of service providers
# Two Levels of Plan Services

## Basic Plan Services
- Administration (directed non-fiduciary TPA)
- Recordkeeping
- Custody
- Trustee services (directed non-fiduciary)
- Investments
- Group meetings
- Participant education (generic and non-fiduciary)
- Do-it-yourself participant and trustee resources

## ERISA Fiduciary Services
- Administrative Services Fiduciary
  - Accepts transfer of fiduciary responsibility and liability for daily Plan operations from Plan Sponsor and payroll/HR staff
  - ERISA §3(16) plan administrator

- Participant Investment Advisor
  - Individualized personal investment advice
  - ERISA §3(21) investment advisor
  - CFP® personal financial planning

- Plan Investment Manager
  - Formal discretionary investment advisory services
  - ERISA §3(38) investment manager

- Fiduciary Governance & Compliance
  - Assumes liability for assuring proper discharge and documentation of fiduciary duty
  - Responsible for assembly, coordination and oversight of service providers
How Fiduciary Risk is Usually Managed

*ONLY Basic Plan Services are Provided*

- **Plan Fiduciaries**
  - **Plan Sponsor**
    - **Plan Fiduciaries**
      - **Non-Fiduciary Investment Services** (Broker, Agent, Registered Rep, Platform Direct)
      - **Non-Fiduciary Administrative Services** (Producing TPA, Bundled Product, Platform Direct)

- **Fiduciary Liability**
  - **Plan Level Investment Decisions**
    - Responsibility & Liability for Investments
  - **Participant Investment Decisions**
  - **Administration, Recordkeeping, & Custody**
    - Responsibility & Liability for Plan Operations

11B-53
How Fiduciary Risk Should be Managed

Use *Wasted Money* to Pay for Fiduciary Controls and Services

**Independent Professional Fiduciary**

- Plan Fiduciaries
- Plan Sponsor
- Plan Fiduciaries
- Independent Professional Fiduciary

**Outsourced Fiduciary Services**
(a.k.a. Fiduciary General Contractor)

- Plan Level Investment Decisions
- Participant Investment Decisions

- Responsibility & Liability for Investments

- Administration, Recordkeeping, & Custody

- Responsibility & Liability for Plan Operations
How Fiduciary Risk Should be Managed

Use *Wasted Money* to Pay for Fiduciary Controls and Services

ERISA §3(38) and §3(21)
Fiduciary Investment Advisors provide fee-only investment advice and accept fiduciary responsibility and liability

ERISA §3(16)
Administrative Services Fiduciary assumes the responsibility and liability for day-to-day plan operations and oversight

ERISA §3(21)
Participant Investment Advisor

Plan Fiduciaries

Plan Sponsor

Independent Professional Fiduciary

Plan Fiduciaries

Independent Professional Fiduciary

Plan Level Investment Decisions

Participant Investment Decisions

Responsibility & Liability for Investments

Administration, Recordkeeping, & Custody

Responsibility & Liability for Plan Operations

Plan Investment Manager

Participant Investment Advisor

Independent Recordkeeper & Custodian

Plan Fiduciaries

ERISA §3(16)
Administrative Services Fiduciary
Certification Resources
Formal Documentation of Compliance

• Level 1 (Entry Level – DIY)
  — Self-Assessment of Fiduciary Excellence
  — Fiduciary Risk Insight Scorecard (*included in your handouts*)

• Level 2 (Formal Consulting Engagement)
  — Consultant’s Review of Fiduciary Practices

• Level 3 (ISO-like Certification Audit)
  — CEFEX Assessment of Fiduciary Excellence

CEFEX is an independent global assessment and certification organization located in Toronto, Canada.

Their assessment process is based on ISO 19011 and is conducted in accordance with ISO 17021.

Complete Online @ safe.actifi.com
Build and Maintain an
Audit Ready Fiduciary File

- Facilitates proactive fulfillment of fiduciary duty
- Streamlines plan operations, governance, and oversight
- Minimizes scramble in event of DOL investigation or other inquiry
- Improves likelihood of successful outcomes

The ultimate protection for Plan Fiduciaries is sound internal fiduciary controls and comprehensive documentation.
Sample Structure for an Audit Ready Fiduciary File

**Plan Document and Agreements**
- Plan, Trust, and Amendments
- Adoption agreement
- Summary Plan Description
- IRS Letter of Determination & correspondence
- Trustee committee appointments & acceptance
- Fidelity bond and fiduciary liability insurance
- Service provider and custodian agreements

**Annual Regulatory Compliance**
- Form 5500 and audited financial statements
- Summary annual report w/ distribution list
- 408(b)(2) & 404(a)(5) disclosures w/ distribution list
- Safe harbor notices w/ distribution list
- Compliance testing results
- Annual summary of plan assets
- Eligibility and open enrollment notification

**Oversight and Governance**
- Investment Policy Statement
- Minutes of trustee and committee meetings
- Consent resolutions/documentation of actions
- Quarterly plan asset & demographic summary report
- Quarterly investment monitoring report
- Initial and ongoing investment due diligence results
- Model portfolio monitoring & asset allocation reports
- Quarterly fee documentation and invoices
- Contribution processing and timing report
- Distribution processing and timing report
- Fiduciary compliance assessment
- Fee benchmarking results
- Listing of direct and indirect service providers and due diligence
- Plan related correspondence
- Participant/employee communication
Fee Disclosure Compliance

An Additional Burden of Knowledge for Plan Fiduciaries
Did You Know?

- Under ERISA §406(a) it is a **Prohibited Transaction** to pay any party in interest (e.g. plan service providers and investment advisors) from plan assets

- ERISA §408(b)(2) offers a statutory exemption *if and only if all three of the following criteria* are met
  1. Service is necessary
  2. Contract (arrangement) is reasonable
  3. No more than reasonable compensation is paid
Lack of Prior Enforcement Due to a Thirty-Eight Year Conundrum

- Since 1974 Plan Fiduciaries have had an explicit obligation to document and monitor plan fees and make a determination that they are reasonable.

- In 1997, DOL Advisory Opinions 97-15A and 97-16A extended this obligation to include service provider compensation.

  However

- Service providers have not had a corresponding obligation to disclose their total fees, compensation, and revenue sharing arrangements.
Information Included on the §408(b)(2) Fee Disclosure Document

• **Services to be provided to the plan**
  • Specific scope and details should be documented in signed service contract

• **Fiduciary status of service provider**
  • If serving in a fiduciary, the service provider must state so in writing
  • Their silence is equivalent to stating they are not serving in a fiduciary capacity

• **Prospective fees and compensation**
  • Direct and indirect compensation (revenue sharing, etc...)
  • Money or anything of monetary value (research, conferences, etc...)
  • *May be described or estimated as a dollar amount, percent of assets, per capita charge or any other reasonable method determined by the service provider*
In Other Words...

…the amended §408(b)(2) regulations simply require service providers to tell the truth, the whole truth, and nothing but the truth regarding the fees they are charging, the compensation they are receiving, and the scope of their legal obligation for the welfare of the 401(k) plan and its participants.
The 401(k) Providers’ “To Do” List

1. Service providers’ must prepare a disclosure document in the layout and numerical format of their preference
   • July 1, 2012 or any time there is a change in fees, compensation, or services provided
Plan Fiduciaries’ “To Do” List cont...

1. Determine which service providers need to provide disclosure documents.

2. Confirm that disclosure documents were actually received.
   • Obligated to notify non-compliant service providers and request document
   • If the missing disclosure is not received within 90 days of written request
     • Plan Fiduciary is legally obligated to fire the service provider
     • Must report the service provider to the Department of Labor

3. Review the disclosure documents prepared by the covered service providers to assure they are complete, accurate, and comply with the amended fee disclosure regulations.
Plan Fiduciaries’ “To Do” List

4. Evaluate the disclosure documents for conflicts of interest.

5. Compile, aggregate, and document all of the direct and indirect fees paid by the plan and the actual compensation received by each service provider.

6. Make a formal determination if their plan’s total fee structure is reasonable relative to the services being provided.

61% of middle-market plan sponsors don’t feel prepared for new fee disclosure rules
[Verisight and McGladrey 2011/2012 Compensation Retirement and Benefits Trends Surveys]
Is Your Plan in Compliance?

Plan Sponsors and Plan Fiduciaries who simply filed the disclosure documents they received and did not Confirm, Review, Compile, and Benchmark their Plan’s fees have not satisfied the requirements needed to qualify for the statutory exemption provided by ERISA §408(b)(2) and will be deemed to have entered into a Prohibited Transaction.

Potential penalties include monetary penalties under Title I of ERISA, excise tax penalties under IRC §4975, and retroactive reimbursement to the plan of excessive fees.
Two Approaches for Documenting Fees and Determining Reasonableness

1. Request and review proposals from four or five 401(k) providers

2. Obtain an independent 3rd party benchmarking study

When using either approach, be sure to compare plan fees against peer group averages and a dollar-based cost-plus analysis of the services actually being delivered
So What?!?
Auditing Requirement

AICPA Audit and Accounting Guide §11.20

If auditor concludes that the plan has entered into a prohibited transaction with a party in interest*, and the transaction has not been properly disclosed in the required supplementary schedule, the auditor should:

(a) Express a qualified opinion or an adverse opinion on the supplementary schedule if the transaction is material to the financial statements

(b) Modify his or her report on the supplementary schedule by adding a paragraph to disclose the omitted transaction if the transaction is not material to the financial statements.

If the client refuses to accept the auditor’s report as modified, the auditor should withdraw from the engagement and indicate the reasons for withdrawal in writing to the plan administrator or board of trustees.

*Implies that the auditor is responsible for and has investigated and evaluated the plan for prohibited transactions.
DOL Fee Disclosure Initiative
AICPA Employee Benefit Plans Conference—May 2012

Accounting

Plan Auditors Have Major Role in Enforcing Service Provider Disclosures, Official Says

ATLANTA—Employee benefit plan auditors have a professional duty to help employers get their plans service provider arrangements in writing by July 1, a Department of Labor official said recently at the American Institute of Certified Public Accountants Conference on Employee Benefit Plans.

By July 1, service providers must disclose in writing to plan fiduciaries any service arrangements valued at more than $1,000 between a plan and a service provider subject to Section 408A(4) of the Employee Retirement Income Security Act for the arrangements to be considered “reasonable,” said lan Dingwall, chief accountant at DOL’s Employee Benefits Security Administration.

“It is critically important that this happen because, frankly, if it doesn’t happen, you’re going to be in the business a year from now informing us at the Department of Labor that you caught your clients involved in a prohibited transaction,” Dingwall said April 20 at the conference.

Audit Will Be Essential. The new disclosure requirements will “kick in during the summer months when you are not doing your audits of employee benefit plans, and your clients will need lots of help,” Dingwall said.

“You don’t want to be in the business of embarrassing a client by not telling them something that you readily know about, and so I would suggest you reach out to them.”

—lan Dingwall, chief accountant at EBIA

“You don’t want to be in the business of embarrassing a client by not telling them something that you readily know about, and so I would suggest you reach out to them,” he said.

Service providers and plan fiduciaries with existing arrangements must bring those arrangements into compliance by July 1, according to Section 408A(3)(b) final regulations (29 FR 3613, March 30). No nondisclosure agreements can be made after July 1.

“Employees need to be the enforcers of this service provider disclosure requirements,” Dingwall said. [3:13]

—lan Dingwall, chief accountant at EBIA

To ensure that you have a service provider agreement that is written in writing, it is a prohibited transaction, and you will be required to inform your clients,” he said.

“You have to tell us at the Department of Labor that your clients participated in a prohibited transaction, and it has to be reported on Schedule G,” the financial transactions schedule for Forms 5500.

“If it wasn’t reported on Schedule G, you have to tell us that,” he said.
DOL Fee Disclosure Initiative
AICPA Employee Benefit Plans Conference—May 2012

Ian Dingwall, Chief Accountant, EBSA

- Auditors “in large part, are going to be the enforcers of this service provider disclosure requirement”

- “if it occurs to you that they (your client) had a service agreement that was not in writing, it is a prohibited transaction, and you will be required to inform on your clients”

- “if it doesn’t happen, you’re going to be in the business a year from now of informing us at the Department of Labor that you caught your clients entered into a prohibited transaction”
“In certain offices, investigators have been instructed to find out if §408(b)(2) is being complied with as a normal part of all investigations where these regulations apply regardless of the reason for which the investigation was initiated.”

- Examination of all required documentation
- A determination if the employer understood their service providers’ business models and fee arrangements.
- Finally, investigators will want to examine the methodology used by the employer to evaluate plan fees and how the employer determined if their plan’s fees are reasonable.
Marc I. Machiz, Director, Philadelphia Region, EBSA

- Region now making an effort to focus on “excessive fee cases”
- “In all of our cases where we have 401(k) plans as part of our investigations, we’re asking to see those disclosures.”

1. What do the disclosures look like?
2. What do the fiduciaries look at?
3. Is there something that justifies high fees?
4. Are the excessive fees the fault of the disclosures?
5. Are the excessive fees the fault of the service provider?
6. Are the excessive fees the fault of the named fiduciary plan sponsor?
Participants’ Questions and Concerns About Plan Fees

In **August 2012** plan participants started receiving detailed information regarding the fees being deducted from their 401(k) account

- Annual disclosure document to be prepared and distributed by employer (but usually delegated to provider)
- Actual dollar figures are now **included on quarterly statements**

**HR and Benefits Departments better have a good answer and a strategy in place when employees start asking questions**

- Between 60% and 70% of participants think their 401(k) is free
- More than 90% of claims are filed by plan participants

**Why Am I Paying So Much for My 401(k)??!**
Is Your Company's 401(k) Plan Operated by any of these Insurance Companies:

- Transamerica
- Lincoln Financial Group
- Hartford Financial Group
- Nationwide
- AXA, or
- John Hancock?

If So, You May Have Legal Claims Against, Transamerica, Lincoln Financial Group, Hartford Financial Group, Nationwide, AXA or John Hancock.

These potential claims are related to fees and charges taken from retirement assets by Transamerica, Lincoln Financial Group, Hartford Financial Group, Nationwide, AXA or John Hancock.

For a free consultation to learn more about your potential claims contact Robert L. Lakind, Esq. at (609)275-0400 or rlakind@szaferman.com

**KNOW YOUR RIGHTS! WE CAN HELP!**

Contact the law firm of Szaferman, Lakind, Blumstein & Blader, P.C.

Attn: Robert Lakind, Esq.
rlakind@szaferman.com
1.609.275.0400
1.888.534.2571
Quit Wasting Money
*Many Plan Fees are 20%-60% Higher than Necessary*

Sample Results of Retirement Plan Fee Audit and Benchmarking Studies

<table>
<thead>
<tr>
<th>Plan Size</th>
<th>Plan Provider</th>
<th>Excess Fees Identified as Being Charged for Basic Plan Services (Based on Analysis of Direct and Indirect Fees and Revenue Sharing)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$70,000,000</td>
<td>Insurance Company</td>
<td>$380,000 per year</td>
</tr>
<tr>
<td>$62,000,000</td>
<td>Mutual Fund Direct</td>
<td>$173,000 per year</td>
</tr>
<tr>
<td>$18,000,000</td>
<td>Bank</td>
<td>$92,000 per year</td>
</tr>
<tr>
<td>$12,000,000</td>
<td>Insurance Company</td>
<td>$114,000 per year</td>
</tr>
<tr>
<td>$8,000,000</td>
<td>Wirehouse</td>
<td>$19,000 per year</td>
</tr>
<tr>
<td>$8,000,000</td>
<td>Insurance Company</td>
<td>$54,000 per year</td>
</tr>
</tbody>
</table>
Improving Plan Performance and Participant Results

- Save Money
- Mitigate Risk
- Improve Employee Satisfaction and Results
Participants’ Retirement Concerns

- The 401(k) is the only or primary source of retirement savings for 70% of plan participants [Koski Research, survey conducted for Charles Schwab, 2011]
- 43% of Americans have less than $10,000 in retirement savings
- 70% of employees have little or no faith in Social Security Retirement Benefits
- Only 13% of employees say they’re very confident about having a comfortable retirement?
  [Employee Benefit Research Institute, Retirement Confidence Survey (2010-11)]
Did the 401(k) **Really** Fail?

... or are there other factors at work?
Participants’ Retirement Planning Process

- **45%** of participants spend less than 4 hours per year on their 401(k)
  - **73%** of participants spend less than 8 hours per year on their 401(k)

- About **50%** of participants say they lack the time, knowledge, and interest to manage their 401(k)

- Of those who do, **41%** rely on family, friends and co-workers for investment advice

[Koski Research, survey conducted for Charles Schwab, 2011]
Typical Efforts to Help Do Not Work

- 62% of HR professionals say that participants don’t utilize the 401(k) education, investment tools, resources, and seminars available to them.

- 56% of participants surveyed don’t review or use plan-related educational materials.
  - (16% are not aware they received it!)
  [Koski Research, survey of senior finance and HR executives conducted for Charles Schwab, 2011]

- Plan participants are too busy with work and family responsibilities to become actuaries, financial planners, and portfolio managers.
Stop the Insanity
Stop the Insanity

• What Plan Sponsors Intend to Do
  – 93% intend to roll out more Interactive Web-Based Tools
  – 93% intend to distribute more Education Materials
  – 81% intend to schedule more Workshops and Seminars

• What Employees Really Need
  – 83% of participants want professional Investment Management and Advice to help them manage their 401(k)
  – Only 16% of plan sponsors intend to make these services available!

[Koski Research, survey of senior finance and HR executives conducted for Charles Schwab, 2011]
In 2011 AonHewitt released a study that documented a 2.92% per year boost in investment returns for participants using fiduciary investment advice and services.

[AonHewitt, Help in Defined Contribution Plans: 2006 through 2009 (Sept 2011)]
Fees
Fees
Fees
11B-86
Case Studies
Mitigating Fiduciary Risk & Improving Participant Welfare
*at No Extra Cost*

1. Leverage Fee Disclosure to Identify Excessive Plan Fees
2. Redirect Savings to Pay for Fiduciary Services
## Case Study #1

**Plan Size:** $61.8MM | 743 employees  
**Provider:** Large Mutual Fund Company

<table>
<thead>
<tr>
<th></th>
<th>Total Fee Currently Being Charged to Plan</th>
<th>Peer Group Plans Average Fee</th>
<th>Total Fee When Charging a Cost-Plus Flat-Dollar Fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost for Basic Plan Services (Direct billed fee)</td>
<td>$4,050</td>
<td>--</td>
<td>$102,792</td>
</tr>
<tr>
<td>Mutual Fund Expenses % (Indirect fee)</td>
<td>0.60%</td>
<td></td>
<td>0.16%</td>
</tr>
<tr>
<td>Mutual Fund Expenses $ (Indirect fee)</td>
<td>$371,030</td>
<td></td>
<td>($173,287)</td>
</tr>
<tr>
<td>Annual Cost for Basic Plan Services Only</td>
<td>$375,080</td>
<td>$457,603</td>
<td>$201,793</td>
</tr>
<tr>
<td>Cost for Comprehensive Fiduciary Services (Direct billed fee)</td>
<td>not being provided</td>
<td></td>
<td>($18,216)</td>
</tr>
<tr>
<td>Total Annual Cost of Plan Operations</td>
<td>$375,080</td>
<td>$457,603</td>
<td>$356,864</td>
</tr>
<tr>
<td>Projected Value of Plan Assets in 9 Years (Based upon current net cash flow)</td>
<td>~$138,275,801</td>
<td></td>
<td>~$157,551,047</td>
</tr>
</tbody>
</table>

- **Potential Increase in Projected Assets from the Combination of Cost Savings and Addition Fiduciary Services:** $19,275,246
- **Remaining Savings After Adding Comprehensive Fiduciary Services:** $155,071
- **Excess Fees Currently Being Charged Each Year for Basic Plan Services:** ($173,287)
- **Total Annual Cost of Plan Operations:** $375,080
- **Total Fee When Charging a Cost-Plus Flat-Dollar Fee:** $356,864
- **Projected Value of Plan Assets in 9 Years:** ~$157,551,047

*11B-88*
# Case Study #2

**Plan Size:** $17.6MM | 257 employees  
**Provider:** Large Regional Bank

<table>
<thead>
<tr>
<th></th>
<th>Total Fee Currently Being Charged to Plan</th>
<th>Peer Group Plans Average Fee</th>
<th>Total Fee When Charging a Cost-Plus Flat-Dollar Fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost for Basic Plan Services <em>(Direct billed fee)</em></td>
<td>$0</td>
<td>--</td>
<td>$12,780</td>
</tr>
<tr>
<td>Mutual Fund Expenses % <em>(Indirect fee)</em></td>
<td>0.81%</td>
<td>--</td>
<td>0.23%</td>
</tr>
<tr>
<td>Mutual Fund Expenses $ <em>(Indirect fee)</em></td>
<td>$147,676</td>
<td>--</td>
<td>$42,627</td>
</tr>
<tr>
<td><strong>Annual Cost for Basic Plan Services Only</strong></td>
<td>$147,676</td>
<td>$121,880</td>
<td>$55,407</td>
</tr>
<tr>
<td>Cost for Comprehensive Fiduciary Services <em>(Direct billed fee)</em></td>
<td>not being provided</td>
<td>--</td>
<td>$49,903</td>
</tr>
<tr>
<td><strong>Total Annual Cost of Plan Operations</strong></td>
<td>$147,676</td>
<td>$121,880</td>
<td>$105,310</td>
</tr>
<tr>
<td>Projected Value of Plan Assets in 9 Years <em>(Based upon current net cash flow)</em></td>
<td>$34,735,079</td>
<td>$42,627</td>
<td>$5,400,088</td>
</tr>
</tbody>
</table>

**Excess Fees Currently Being Charged Each Year for Basic Plan Services:** ($92,269)

**Remaining Savings After Adding Comprehensive Fiduciary Services:** ($42,366)

**Potential Increase in Projected Assets from the Combination of Cost Savings and Addition Fiduciary Services:** ~$40,135,167
### Case Study #3

**Plan Size:** $9.5MM | 90 employees  
**Provider:** Large National Insurance Company

<table>
<thead>
<tr>
<th></th>
<th>Total Fee Currently Being Charged to Plan</th>
<th>Peer Group Plans Average Fee</th>
<th>Total Fee When Charging a Cost-Plus Flat-Dollar Fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost for Basic Plan Services <em>(Direct billed fee)</em></td>
<td>$14,550</td>
<td>--</td>
<td>$19,100</td>
</tr>
<tr>
<td>Mutual Fund Expenses % <em>(Indirect fee)</em></td>
<td>0.71%</td>
<td></td>
<td>0.36%</td>
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<tr>
<td>Mutual Fund Expenses $ <em>(Indirect fee)</em></td>
<td>$67,450</td>
<td></td>
<td>$34,200</td>
</tr>
<tr>
<td><strong>Annual Cost for Basic Plan Services Only</strong></td>
<td><strong>$82,000</strong></td>
<td><strong>$91,200</strong></td>
<td><strong>$53,300</strong></td>
</tr>
<tr>
<td>Cost for Comprehensive Fiduciary Services <em>(Direct billed fee)</em></td>
<td>not being provided</td>
<td></td>
<td><strong>$30,800</strong></td>
</tr>
<tr>
<td><strong>Total Annual Cost of Plan Operations</strong></td>
<td><strong>$82,000</strong></td>
<td><strong>$91,200</strong></td>
<td><strong>$84,100</strong></td>
</tr>
<tr>
<td>Projected Value of Plan Assets in 9 Years <em>(Based upon current net cash flow)</em></td>
<td>~$17,857,994</td>
<td></td>
<td>~$20,280,357</td>
</tr>
</tbody>
</table>

- **Excess Fees Currently Being Charged Each Year for Basic Plan Services** ($28,700)
- **Remaining Savings After Adding Comprehensive Fiduciary Services** ($2,100)
- **Potential Increase in Projected Assets from the Combination of Cost Savings and Addition Fiduciary Services** $2,422,363
## Case Study #4

**Plan Size:** $7MM | 99 employees  
**Provider:** Large National Insurance Company

<table>
<thead>
<tr>
<th>Description</th>
<th>Total Fee Currently Being Charged to Plan</th>
<th>Peer Group Plans Average Fee</th>
<th>Total Fee When Charging a Cost-Plus Flat-Dollar Fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost for Basic Plan Services (Direct billed fee)</td>
<td>$0</td>
<td>--</td>
<td>$16,710</td>
</tr>
<tr>
<td>Mutual Fund Expenses % (Indirect fee)</td>
<td>1.31%</td>
<td>0.38%</td>
<td></td>
</tr>
<tr>
<td>Mutual Fund Expenses $ (Indirect fee)</td>
<td>$91,000</td>
<td></td>
<td>$26,260</td>
</tr>
<tr>
<td>Annual Cost for Basic Plan Services Only</td>
<td>$91,000</td>
<td>$81,200</td>
<td>$42,970</td>
</tr>
<tr>
<td>Cost for Comprehensive Fiduciary Services (Direct billed fee)</td>
<td>not being provided</td>
<td></td>
<td>$25,900</td>
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<tr>
<td>Total Annual Cost of Plan Operations</td>
<td>$91,000</td>
<td>$81,200</td>
<td>$68,870</td>
</tr>
<tr>
<td>Projected Value of Plan Assets in 9 Years (Based upon current net cash flow)</td>
<td>~$12,141,180</td>
<td></td>
<td>~$14,243,935</td>
</tr>
</tbody>
</table>

- **Excess Fees Currently Being Charged Each Year for Basic Plan Services**: ($64,740)
- **Remaining Savings After Adding Comprehensive Fiduciary Services**: ($22,130)
- **Potential Increase in Projected Assets from the Combination of Cost Savings and Addition Fiduciary Services**: $2,102,755
Next Steps

• Benchmark Plan Fees
  – Use an independent 3rd party

• Reduce Fees Today
  – Avoid revenue sharing
  – Scrutinize proprietary funds

• Control Fees as Plan Grows Over Time
  – Avoid percent of asset fees
  – Convert to a cost-plus flat-dollar fee structure

• Use Savings to Pay for Fiduciary Services
  – Properly manage fiduciary risk
  – Affirm and/or improve compliance
  – Improve participant services and results

• Build an Audit Ready Fiduciary File
  – Document compliance and governance oversight
  – Use Prudent Practices Handbook as a guide

11B-92