A 2010 Wakeup Call for 403(b) Fiduciaries

New regulations, new risks and steps plan sponsors can take now to protect themselves and their participants

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Introduction

Last year, the focus for many 403(b) plan sponsors was a looming deadline – December 31, 2009 – by which written plan documents had to be adopted. Now that 2010 is underway, plan sponsors face new challenges, including increased reporting requirements and potential investigations and penalties. For 403(b) plans subject to the Employment Retirement Income Security Act of 1974 (ERISA), fiduciaries have more exposure than ever before, because this is the first time that detailed reporting has been required.

How prepared are plan sponsors and their board members and others to manage their new fiduciary responsibilities? The answer varies widely, depending on the size and resources of the plan sponsor. While the limited research available this early in the year suggests that the largest plan sponsors are on top of the new regulations, smaller nonprofits and many colleges, universities and school districts may be struggling to implement the new guidelines. Meanwhile, members of their boards may be unaware of their new fiduciary responsibilities and, consequently, their potential personal liability. They may also be unaware of the limited ability of many vendors to help them fulfill those fiduciary responsibilities.

The purpose of this paper is to give a brief overview of the changing 403(b) environment, alert plan sponsors to the need for increased fiduciary awareness and suggest steps they can take to protect themselves, their board members, other fiduciaries and ultimately, their participants.

Increased likelihood of investigations

A recent *PLANSPONSOR* article titled, "Plan Sponsors Beware – The DOL investigations are coming"[1] sounds the wakeup call and warns that three factors are likely to increase the number of investigations conducted by the Department of Labor's Employee Benefits Security Administration (EBSA) in 2010. First, the recession is triggering more participant complaints to the Labor Department's toll-free number, which initiate a "sizeable percentage" of EBSA investigations. A second factor is a proposed 9 percent budget increase in 2010 for the EBSA, including approximately 75 additional investigators.

The *PLANSPONSOR* article reports administrative developments as a third factor. In the past, ERISA 403(b) plans were exempted from most of the Form 5500, Annual Return/Report of Employee Benefit, except for basic information such as providing the name of the employer and contact information. The Department of Labor revoked that exemption starting with 2009 year-end plans filed in 2010. For the first time, 403(b) plans are required to file a complete Form 5500, which includes a schedule detailing service providers' fees charged to the plan. This form will make it easier for the EBSA to identify service providers whose fees could be considered excessive, which may trigger more investigations.

[1] "Plan Sponsors Beware – The DOL investigations are coming," *PLANSPONSOR* - December 18, 2009, www.plansponsor.com (accessed January 19, 2010).

Another significant administrative change may also affect plan sponsors. In July 2009, the Labor Department and the Securities and Exchange Commission (SEC) issued a joint Memorandum of Understanding (MOU). In an article posted on businessofbenefits.com, Robert J. Toth, Jr., comments, "The MOU was particularly striking in that the two agencies committed to increased *investigative* cooperation."[2]

According to *PLANSPONSOR*, "All these factors portend an EBSA that is proactive: more investigators with access to additional data responding to increased participant complaints. One of the most important actions a plan sponsor can take is either to perform a fiduciary self-audit and assessment or have a third party conduct the fiduciary assessment. The person performing the assessment should be well-versed in ERISA's fiduciary mandates and EBSA's investigations. More EBSA investigators, coupled with an increase in participants' complaints, signal consequences for plan officials that could be critical."[3]

A Government Accountability Office (GAO) report on retirement savings (GAO-09-641) issued in September 2009 also put a new spotlight on 403(b) fees and plan sponsor actions – or inactions – that can affect participants' retirement savings. The report states, "However, participants in some plans are more likely to invest in products that may have higher fees. For example, we found that participants in 403(b) plans and individual IRAs are more likely to invest in products like individual variable annuities or retail mutual funds, which frequently charge more than other investments. According to experts, one reason for the different investments is that many 403(b) plan sponsors do not make group products available to participants. … 401(k) and 401(a) plan sponsors frequently pool participants' assets to realize lower fees in mutual funds, but sponsors of 403(b) plans often do not. Instead, many 403(b) plan sponsors keep sponsor involvement to a minimum, which limits the opportunities to pool assets and decrease fees."[4]

[2] "SEC's and DOL's Cross Agency Waltz: The ERISA Connection to Disclosure, Advice, Compensation and Conflict of Interest," by Robert J. Toth, Jr., www.businessofbenefits.com/uploads/file/Toth_PCRM_03-09(2).pdf (accessed January 26, 2010).

[3] "Plan Sponsors Beware – The DOL investigations are coming," PLANSPONSOR - December 18, 2009, www.plansponsor.com (accessed January 19, 2010).

[4] United States Government Accountability Office, Report to the Chairman, Committee on Ways and Means, House of Representatives, "RETIREMENT SAVINGS – Better Information and Sponsor Guidance Could Improve Oversight and Reduce Fees for Participants," GAO-09-641, September 2009, page 2.

Critical lack of awareness among fiduciaries

Despite increased scrutiny and regulatory pressure on all sides, the awareness of plan sponsors varies widely, depending on plan size, assets under management and whether the plan is subject to ERISA.

An AllianceBernstein study of 1,000 plan sponsors, *Inside the Minds of Plan Sponsors,* released in January 2010 reports that 37% of survey respondents said "no" when asked if they considered themselves to be plan fiduciaries. "In other words, they know they're plan sponsors, but they may not realize they're plan fiduciaries." The study also reports that "Whether plan sponsors know they're fiduciaries or not, they're not particularly confident that all individuals serving in a fiduciary capacity are aware of their fiduciary status. Only a little more than half of respondents feel confident of that."[5]

The fiduciaries in your midst – from plan administrators to board members

The AllianceBernstein study points out the uncertainty about fiduciary roles, which our experience shows is especially widespread among 403(b) plan sponsors such as colleges, universities and small to mid-sized non-profits.

According to ERISA, **any person who exercises decision-making authority over or discretionary control in the management of the plan or its assets is considered to be a fiduciary.**

There are three ways to become a fiduciary: ERISA can identify you as one, you can be appointed to a fiduciary role by a named fiduciary, or you can become one by exercising decision-making authority or discretionary control over the plan or effectively controlling its assets, even if you were never formally delegated any authority.

Examples often include the investment manager, plan advisor and plan committee members (if you have a plan committee). Board members or senior corporate officers may be considered fiduciaries in the absence of stated designations.

Service providers such as attorneys, actuaries and third-party administrators and accountants whose work does not satisfy the definition will not be considered fiduciaries. Employees and service providers who are providing strictly operational functions (like the processing of forms), will also not be considered fiduciaries because their work is considered "ministerial" in nature.

Are you a fiduciary?

Check to see if your role falls into one of the following fiduciary categories:

- "Named fiduciaries" – anyone named in the plan as a fiduciary. If the employer is named as fiduciary, board members and senior officers may be considered fiduciaries, even if they are unaware.
- Anyone who gives direct or indirect investment advice for compensation with respect to plan assets or has any authority or responsibility to do so.
- Anyone who has discretionary authority or responsibility in the administration of the plan, including the investment manager, plan administrator and, in some cases, board members or corporate officers.

To state it another way, GAO-09-641 summarizes, 'Under ERISA, a person is generally a fiduciary with respect to a plan, to the extent they exercise any discretionary authority or control over plan management or any authority or control over the management or disposition of plan assets, render investment advice respecting plan money or property for a fee or other compensation (or has the authority or responsibility to do so), or have discretionary authority or responsibility for plan administration."[6]

[5] AllianceBernstein, *Inside the Minds of Plan Sponsors,* January 2010, www.alliancebernstein.com (accessed January 26, 2010).

[6] United States Government Accountability Office, Report to the Chairman, Committee on Ways and Means, House of Representatives, "RETIREMENT SAVINGS – Better Information and Sponsor Guidance Could Improve Oversight and Reduce Fees for Participants," GAO-09-641, September 2009, page 9.

Your 403(b) fiduciary responsibilities – four basic rules

ERISA requires that fiduciaries make decisions in the best interests of plan participants and beneficiaries (non-ERISA plans may be subject to state laws regarding fiduciary responsibility for their investment decisions). Fiduciary guidelines can be summarized in four basic rules:

1. The exclusive benefit rule
2. The prudent person rule
3. Investment diversification
4. Consistency with plan documents

Let's take a quick look at how each rule governs the conduct of a fiduciary.

1. Act exclusively in the interest of plan participants and beneficiaries

Also known as the "duty of loyalty," the exclusive benefit rule first requires fiduciaries to act solely for the purpose of providing benefits to participants and their beneficiaries. Any decisions the fiduciary makes must take into account only the interests of the plan and its participants, not the employer. Fiduciaries must also not engage in activities that entail a conflict of interest with regard to the retirement plan. For example, a fiduciary may not receive marketing fees or commissions in exchange for endorsing a particular vendor.

Second, the rule permits for plan assets to be used for reasonable administrative expenses, such as those incurred for amendments required by law, nondiscrimination testing, Form 5500 preparation, audits and benefits calculation. However, expenses incurred for plan design and termination are not payable from plan assets, because they primarily benefit the plan sponsor.

2. Perform duties with the care, skill, prudence and diligence that a prudent person acting in a similar capacity and familiar with the matters at hand would use under the circumstances then prevailing

This "prudent person rule," also called the "duty of care," does not require you to act as an expert. Instead, it requires that you recognize when you are not an expert and that you seek the advice of experts when it is needed, including when circumstances change. For example, this rule requires you to be familiar with "the matters at hand," which include new requirements under the Pension Protection Act of 2006 and ongoing clarifications from the DOL.

3. Diversify plan investments to minimize losses, unless circumstances indicate it is not prudent to do so

Because investment diversification[7] is a fundamental principle of investing success, it's also a fundamental feature of ERISA's requirements. The plan's investment options must also be monitored for performance, and their role in the investment option lineup must be reviewed periodically, even if the funds are held in participant-owned individual 403(b) annuity contracts. Best practices recommend you document this process each time you review a fund and maintain the results in a due diligence file.

Although compliance with ERISA 404(c) is not required, it can protect plan fiduciaries from the consequences of participant investment directions. To comply with ERISA 404(c), participants must have the ability to choose from a broad range of investment options, including:

- The opportunity to exercise control over investments that materially affect their potential return on assets
- A choice of at least three investment options, each of which is diversified and has materially different risk and return characteristics. This does not mean three different 403(b) vendors; it refers to the investments underneath the 403(b) contracts
- The opportunity to diversify investments which may help minimize the risk of large losses

4. Act in a manner consistent with the plan documents, as long as the documents are consistent with ERISA

Consistency must be applied on both levels. For example, if the plan documents do not allow loans, the plan sponsor cannot gratuitously decide to grant a loan without first amending the plan document. The law, however, forbids fiduciaries from following the plan documents if doing so would be imprudent or otherwise violate ERISA.

[7] Diversification does not ensure a profit or protect against a loss in a declining market.

Fiduciary liabilities, breaches of duty and remedies – let's get personal

If you don't carry out the responsibilities required of you under ERISA and fail to follow all of the appropriate processes, or if you take actions contrary to that of a fiduciary, you are considered in breach of your fiduciary duties.

ERISA holds fiduciaries personally liable for losses in the plan if they fail to perform their fiduciary duties. ERISA also provides remedies and potential consequences for breaching fiduciary duties, including:

- Personal liability to restore to the plan any losses it suffered because of the fiduciary's breach
- 15 percent excise tax on the value of any amounts used for the breaching fiduciary's benefit
- Equitable relief as may be required by the court
- A civil penalty of 20 percent of the amount recovered from a fiduciary for a breach
- Criminal sanctions for intentionally engaging in a fiduciary violation
- Disqualification of the person from ever serving as a fiduciary for an ERISA plan

Fortunately, however, under ERISA, a fiduciary cannot be held liable for punitive damages. This is an important protection for fiduciaries, since it shields them from the risk of potential judgments.

A fiduciary may also be liable for another fiduciary's breach if:

- Duties are shared (such as among committee members)
- A fiduciary is aware of another fiduciary's breach and does nothing about it
- A fiduciary fails to monitor another fiduciary's performance when required

Limitations on fiduciary liability under ERISA

One of the biggest fiduciary concerns under ERISA is that a plan fiduciary can be held responsible for an individual participant's investment choices, even though the participant made the investment choice of the particular 403(b) contract (or investment under the contract) on their own. ERISA Section 404(c) remedies this potential exposure. If the requirements of Section 404(c) are satisfied, the fiduciary can be relieved of responsibility for the investment decisions of plan participants in their individual accounts.

There are specific rules that a plan must satisfy to obtain the protection offered under Section 404(c), including allowing the participant to exercise control over the assets in the account and to choose from a broad range of investment alternatives. It may be difficult to meet those requirements for the portion of the 403(b) plan that is funded with individually owned contracts from a variety of different investment vendors. We suggest you consult your retirement plan advisor or consultant and determine whether or not this protection is available to you. Regardless of whether or not Section 404(c) is satisfied, fiduciaries still retain the responsibility to select investment options and 403(b) plan providers prudently, and monitor them on an ongoing basis.

A common fiduciary breach under a 403(b) plan includes the failure to review and monitor the performance of investment funds held in individual annuity contracts or custodial accounts, and to determine whether it is prudent to continue to offer any particular investment to 403(b) plan participants.

Exposure for non-ERISA plans – are you at risk?

Whether you have an ERISA or non-ERISA plan, you have fiduciary responsibilities and liabilities. In fact, while ERISA demands that fiduciaries be held to the highest standard available under the law, it also provides them with unique legal protections. Most state law claims (such as breach of contract or negligence) against fiduciaries by plan participants are preempted by ERISA, meaning that ERISA doesn't allow these sorts of lawsuits to be brought against fiduciaries. In addition, the United States Supreme Court has ruled that punitive damages cannot be awarded against plan fiduciaries under ERISA.

Non-ERISA plans, however, do not enjoy this same protection. If your plan is not an ERISA plan, you are exposed to a number of different liabilities relating to your 403(b) plan's investments and operations, including, in many states, state-law-based fiduciary liability, if you exercise discretionary control over the plan's investments or operations.

While some professionals maintain that state fiduciary rules don't technically apply to non-ERISA 403(b) plans, it would be foolhardy to believe that you would not have some sort of liability should you act haphazardly regarding your plan's investments, particularly if that action resulted in loss to employees.

Even if your state's specific fiduciary laws will not apply to your actions, other state law claims may be asserted. Under state common law agency rules, you could be considered your employees' agent with respect to establishing and administering the plan. With agent status, the risk increases that you owe the duties of prudence and loyalty to your employees in the administration of your 403(b) plan, with requirements much like those for ERISA plans.

In light of the ambiguity of state laws and the "open door" to litigation, some plan sponsors such as public school districts which are not subject to ERISA are choosing to act as if they were, to protect both fiduciaries' and participants' best interests.

Steps you can take now to help protect yourself, fellow fiduciaries and participants

Partnering with a knowledgeable and experienced retirement plan advisor or consultant is the first step. Your advisor or consultant will guide you through the maze of evolving laws and requirements and help you protect the best interests of your participants and fiduciaries. Focus on these key steps:

1. Create or strengthen your Investment Plan Statement (IPS)

Define and follow a clear written investment selection and monitoring process.

2. Appoint a Fiduciary Committee

Write a committee charter and hold regular meetings. By setting up a committee and following your IPS, you may help insulate board members and corporate officers who are not on the Fiduciary Committee, since this "buffer zone" helps separate them from plan responsibilities and liabilities.

3. Partner with a provider who offers a high level of fiduciary support, offers impartial advice and remains revenue neutral

Both the GAO and the website 403(b)Wise recommend using an RFP process to select investment and service providers. GAO-09-641 states, "Sponsors can also issue a request for proposal (RFP) to lower costs and decrease fees charged to participants. In response to an RFP, vendors submit bids describing their services and fees to the sponsor. Sponsors may then choose vendors who meet their participants' needs and may choose vendors with lower fees. For example, one expert told us that a statewide plan reduced total participant fees significantly because they issued an RFP and chose service providers with lower fees."[8]

403(b)Wise provides a list of "Sample Questions to Guide the Selection of Potential 403(b) Service Providers" on their website, also included in the resources section of this paper.

4. Evaluate, select and monitor investments

Reviewing plan investment options on a regular yearly or quarterly basis is considered a best practice.

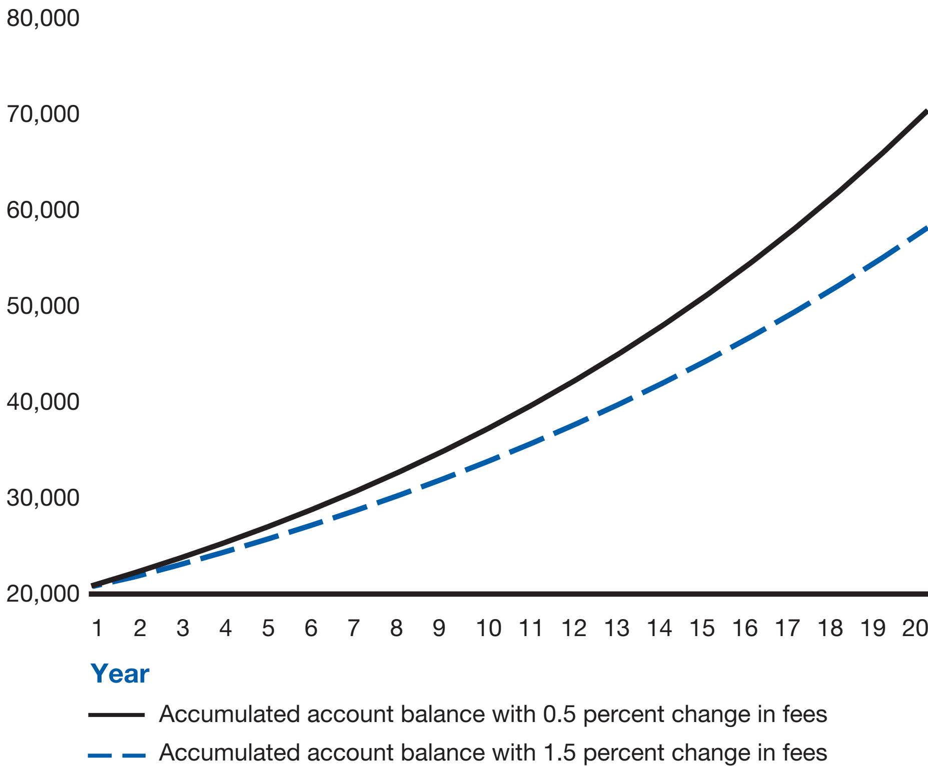
[8] United States Government Accountability Office, Report to the Chairman, Committee on Ways and Means, House of Representatives, "RETIREMENT SAVINGS – Better Information and Sponsor Guidance Could Improve Oversight and Reduce Fees for Participants," GAO-09-641, September 2009, page 19.

5. Fully disclose fees and avoid improper transactions

The information is now required on Form 5500, Schedule A and C. GAO-09-641 provides a compelling example of the long-term effect of fees. The report states, “Lower fees benefit plan participants because they can significantly increase long-term retirement savings. As shown in the chart below, even a relatively small annual fee taken from a worker’s assets represents a large amount of money had it been reinvested over time. Fees are one of many factors — such as the historical performance and risk for each investment option — participants should consider in making their investment decisions.”[9]

Effect of a one percentage point in higher annual fees on a $20,000 DC Plan balance invested over 20 years

Account balance in dollars



Source: GAO analysis

[9] United States Government Accountability Office, Report to the Chairman, Committee on Ways and Means, House of Representatives, “RETIREMENT SAVINGS – Better Information and Sponsor Guidance Could Improve Oversight and Reduce Fees for Participants,” GAO-09-641, September 2009, page 21.

The GAO further reports, "DC plan experts told us that compared to 401(a), 401(k), and 457(b) governmental plans, sponsors of 403(b) plans generally take fewer actions to decrease fees for participants. The 403(b) plan sponsors often establish a direct one-on-one relationship between the service provider and the participant, which means sponsors' main responsibility is to send contributions from employees' paychecks to investment service providers. This one-on-one relationship between participant and service provider keeps sponsors' involvement to a minimum, limiting the ability to reduce fees."[10]

Experts the GAO interviewed gave two reasons why sponsors of some 403(b) plans often take fewer actions to decrease fees. First, many sponsors of 403(b) plans are public schools and tax-exempt organizations, and may not have the resources to hire plan administrators who are retirement plan specialists and instead rely on payroll and administrative staff who may lack guidance. Second, for many state and local governments, 403(b) plans are a secondary retirement benefit to a DB plan and sponsors may not feel as motivated to play an active role in these supplemental plans.[11]

6. Give participants access to appropriate and timely educational materials and resources — not advice — including plan-related information and generic investment information

Ask your plan advisor or plan provider about educational resources.

7. Document everything!

[10] United States Government Accountability Office, Report to the Chairman, Committee on Ways and Means, House of Representatives, "RETIREMENT SAVINGS – Better Information and Sponsor Guidance Could Improve Oversight and Reduce Fees for Participants," GAO-09-641, September 2009, page 21.

[11] United States Government Accountability Office, Report to the Chairman, Committee on Ways and Means, House of Representatives, "RETIREMENT SAVINGS – Better Information and Sponsor Guidance Could Improve Oversight and Reduce Fees for Participants," GAO-09-641, September 2009, page 21-22.

8. Watch out for FABs (Field Assistance Bulletins) and updates from your partners

The DOL issues Field Assistance Bulletins (FAB), which are public statements with practical interpretations of its rules and regulations related to ERISA. For example, **FAB 2009-2: 403(b) ERISA Reporting Relief** allows a plan to disregard "lost" individual annuity contracts in their reporting obligations as long as the following conditions are met:

- The account or contract was issued prior to January 1, 2009
- All contributions to the contract ceased prior to January 1, 2009
- All rights under the contract are legally enforceable by the individual without any involvement by the employer
- All amounts under the contract are fully vested

The same FAB also requires CPAs who are auditing a 403(b) plan's financial statements to disclose to the plan sponsors the elements of the costs of their audits.

Putting fears to rest with the right support

While the new reporting requirements and investigatory climate burden 403(b) plan sponsors with more responsibilities than ever, the good news is, you don't have to go it alone. Even small plans can get valuable support from an unbiased, experienced retirement plan advisor. An initial review of your current plan will point out strengths and potential vulnerabilities. Your advisor can help you understand and execute the steps necessary to protect yourself and your participants. Ultimately, you'll have a stronger plan designed to help your participants achieve their retirement savings goals.

Valuable resources

- **Your retirement plan advisor or consultant**
- **U.S. Department of Labor: www.dol.gov/ebsa**
- **Internal Revenue Service: www.irs.gov**
- **www.403bwise.com**
- **www.businessofbenefits.com**
- **www.benefitslink.com**
- **www.plansponsor.com**
- **IRS FAQs on Final 403(b) Regulations: http://www.irs.gov**
- **ASBO International: "Fiduciary Issues and the Final 403(b) Regulations FAQs" (for public schools and community colleges), http://asbointl.org**

A Checklist for Fiduciaries

This checklist can help you assess whether you are meeting your fiduciary obligations and ERISA requirements. This is not a complete list of ERISA requirements, but it is a good action list for fiduciaries.

1. Have the investment fiduciaries been appointed in a manner consistent with the plan and trust documents?
2. Are all plan fiduciaries aware they are fiduciaries? Have all fiduciaries been informed of their obligations under ERISA?
3. Does the investment committee meet at least once a year?
4. Is a due diligence file maintained with minutes, notes and supporting documentation, such as The Standard's *Quarterly Monitoring Report*, to track investment decisions made at fiduciary meetings?
5. Does the plan have a written investment policy?
6. Does the plan have investments in a diverse group of investment categories, such as the ones below, to ensure participants can choose from a broad range of funds?
   - cash equivalents
   - U.S. government or corporate bonds
   - large cap U.S. equities
   - mid/small cap U.S. equities
   - international or global equities
7. Have the plan fiduciaries reviewed the plan's investments in the last 12 months? Was the review done in compliance with the investment policy?
8. Did your investment provider give you information on the proper peer group indices, expenses, historical performance, volatility and other factors? If not, did you gather that information yourself for review?
9. Are investment costs reasonable in comparison to the appropriate benchmarks? Do fiduciaries fully understand all investment costs and the services provided for these costs?
10. Does the plan provide employee enrollment education explaining the importance of participating, saving for retirement and the basics of investing? Does the plan provide ongoing investment education material or seminars for employees?
11. Do plan fiduciaries ensure the plan collects and invests employee deferrals in a timely manner?
12. Is the plan covered by a fidelity bond of at least 10 percent of plan assets (up to $1 million)? Does the bond cover plan fiduciaries and other employees or third parties who handle or have access to plan assets?
13. Are the fiduciaries covered by fiduciary liability insurance?
14. If the plan intends to employ the fiduciary protections of ERISA Section 404(c), does the summary plan description or other written notice inform participants of:
    - the ability to direct their own investments?
    - the plan's intention to comply with 404(c), and that plan fiduciaries may be relieved of liability for investment losses?
    - the name, address and phone number of the 404(c) plan fiduciary responsible for providing information upon request and for receiving and complying with participant investment instructions?
15. Have all participants received information about each investment option available under the plan?
16. Does the Form 5500 filing indicate that the plan intends to comply with ERISA Section 404(c) requirements?
17. Are you prepared to review the fees and expenses disclosed in Form 5500 Schedule A and Schedule C for reasonableness?
18. Have you reviewed your responsibility for individually owned contracts which may still be part of the plan?

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