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The Seven Simple Truths Every 401K Plan Sponsor Should Know

How to Overcome Challenges, Find Solutions, and Avoid Common 401K Plan Sponsor Mistakes

White Paper

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TABLE OF CONTENTS

The Seven Simple Truths Every 401K Plan Sponsor Should Know:

1. Yes, It's True. **YOU** are a FIDUCIARY
2. You CAN Delegate Your Fiduciary Responsibilities
3. You MUST Understand Your Plan's Fees. ALL FEES
4. Ask the RIGHT Questions of (and Benchmark) Your Current Provider
5. MAINTAIN Your Investment Policy Statement
6. Form an Investment Committee and MEET Regularly
7. MONITOR Your Plan!

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1.Yes, It's True, YOU Are a Fiduciary

The Employee Retirement Income Security Act [ERISA] defines Fiduciary as any person (with respect to a TRUST) who exercises any discretionary authority or discretionary control regarding management of the plan, or exercises any authority or control regarding management or disposition of its assets. Further, anyone who renders investment advice regarding plan assets for a fee or other compensation, direct or indirect, or has any authority or responsibility to do so is also a Fiduciary, as is anyone who has any discretionary authority or discretionary responsibility in the administration of such plan.

Most Plan Sponsors are Unaware of the Many Duties Required of them as 401K retirement plan Fiduciaries.

A fiduciary has several duties which include the Duty of Loyalty, the Duty to Act Prudently, the duty of diversification and the duty to follow plan documents.

The Duty of Loyalty or the Exclusive Purpose Rule, requires the fiduciary to act solely in the interest of the plan participants and beneficiaries and for the exclusive purpose of providing benefits and minimizing expenses.

The Duty to Act Prudently or the Prudent Expert Standard, requires the fiduciary to act with the care, skill, prudence and diligence under the circumstances then prevailing, that a prudent person acting in a like capacity and familiar with such matters would use.

The Duty of Diversification requires the fiduciary to diversify investments of the plan to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so.

The Duty to Follow Plan Documents requires the fiduciary to act in accordance with the documents and instruments governing the plan insofar as such documents and instruments are not inconsistent with the provisions of ERISA including the plan's investment management agreements and investment policy statement.

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ERISA Section 409(a) imposes **personal liability** on fiduciaries that breach their fiduciary duties. The Act states, "Fiduciaries of an employee benefit plan [such as a 401(k) plan] are charged with carrying out their duties prudently and solely in the interests of the participants and beneficiaries of the plan, and are subject to personal liability to, among other things, make good any losses to the plan resulting from a breach of their fiduciary responsibilities"

ERISA Interpretive
Bulletin 96-1

- *In the Enron settlement outside members of the Board of Directors and the chair of the plan committee contributed to the settlement from their personal assets.*

2. You Can Delegate Your Fiduciary Responsibility

ERISA's original intent was for retirement plan investments to be managed and run by experts (just think about a defined benefit plan). When a plan sponsor delegates investment responsibility to outside experts, they are insulated from both responsibility and liability. REPEAT: If investment 'discretion' is taken away from a plan sponsor, there is No Responsibility for specific investment decisions. Therefore, delegation to an investment fiduciary offers **REAL VALUE** for the plan sponsor. Warranties offered by MassMutual and John Hancock exclude fee-based allegations of misconduct. Forget the Warranty and hire an outside Fiduciary. 404(c) is not ENOUGH.

As discretion is the primary trigger of fiduciary responsibility and liability, no discretion equals no responsibility which equals no liability for the plan sponsor. The named fiduciary can CONTROL and MANAGE the operation and administration of the plan.

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3. You Are Required to Understand Your Plan's Fees. ALL Fees

While the law does not prescribe a specific level of fees, it does require that fees charged to a plan be "reasonable." The plan sponsor must know what they are paying for and how these costs compare with the market for reasonableness. There are both explicit and implicit fees such as administrative cost, record keeping fees, custody fees, trustee and brokerage fees. Investment cost fees include investment management fees, expense ratio, bid-ask spread cost and short-term trading fees.

The most recent litigation has focused on plan fees. Complaints generally allege that plan fiduciaries violated various fiduciary duties owed to the plan and its participants by:

- Permitting the plan to pay excessive fees and expenses
- Failing to monitor fees and expenses
- Failing to discover, disclose and stop hidden and excessive fees charged to the plan
- Failing to know the industry trends, developments, practices and policies that affect plans
- Failing to understand the method by which vendors collect revenue from plans
- Failing to establish, implement, and follow procedures to properly and prudently examine fees and expenses paid by the plan
- Failing to disclose the total fees and expenses incurred by the plan to participants
- Failing to clearly communicate to participants about the transactions, fees and expenses affecting their account balance

*By delegating, plan sponsors **minimize** risk related to the plan AND **maximize** the wealth for their participants***.**

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Hecker v. Deere & Co., 556 F.3d 575, rehearing en banc denied, 569 F.3d. 708 (7th Cir. 2009).

The Court held that where a plan offers a diverse array of investment options and management fee structures and where the total fee charged by each fund is disclosed to investors, no ERISA breach of fiduciary duty claim can be stated based on a theory of excessive fees or the failure to disclose revenue sharing payments

In a similar case, Caterpillar agreed to $16.5 million settlement *and* to "increase and enhance communication with employees about 401(k) investment options and associated fees" They also agreed to hire an independent fiduciary (delegate).

According to a study by Seyfarth Shaw, LLP, the monetary value of the top 10 private settlements of ERISA class actions was $499.5 million in 2009.

4. Ask the RIGHT Questions of (and Benchmark) Your Service Providers

The plan sponsor must ask the **right** questions of their service providers. These providers include insurance companies, mutual fund companies, brokers/investment professionals, banks and third-party administrators. As a plan sponsor, you have a **Duty to know**.

"*A pure heart and an empty head are not enough to defend against fiduciary breach*" Donovan v. Cunningham, 716 F. 2d 1455 (5th Cir. 1983), cert. Denied, 467 US 1251 (1984)

Plan Sponsors hold many **Common Misconceptions** about Benchmarking such as:
"Our provider does this for us" *or* "It's not necessary because we are with…
the leading provider *[Fidelity was the trustee and record-keeper for Deere]…*
the biggest provider *[ING, Hartford and John Hancock have also been sued]* …
the lowest cost provider *or* "It's too much work, not critical and just too expensive" [*see Caterpillar]*

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Here are the **Facts** about Benchmarking. It requires some effort but is not difficult. It always results in a greater understanding of plan fees and services and almost always materially lowers costs, increases service and reduces fiduciary exposure. Benchmarking also often yields surprises.

Proper benchmarking involves a review of all fees, investments, plan provisions, and participant needs. Benchmarking also provides a comparison of similar types of plans and those within your industry.

5. Maintain Your Investment Policy Statement

The Investment Policy Statement[IPS] should include the following sections; an evaluation of the specific needs of the plan and its participants, the investment objectives and goals of the plan, a definition of duties and responsibilities of all parties involved, defined due diligence criteria for selecting investment options for the plan, classes and styles of investments authorized[restrictions on investments], standards and benchmarks of investment performance to which the 401(k) plan assets are compared, policy and procedures related to hiring, monitoring, and replacement of investment managers , and procedures for monitoring and controlling investment expenses.

6. Form an Investment Committee and Meet Regularly

The plan sponsor should form a Committee whose purpose is to establish, execute and interpret the Investment Policy Statement. The committee also selects the investment managers, custodians, and advisors to the plan (delegate). The process should be documented, formalized and established in writing.

7. Monitor Your Plan

The plan sponsor should implement an ongoing program for measuring investment performance including consistency of style, changes in management and fraudulent or improper activity. Service Providers should be evaluated regularly.

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For more than 25 years, we've been helping our clients help protect their wealth and build their financial futures by educating and empowering them through smart planning and advice focused on what they find important.

Please contact our office for additional information. **(952) 474-1270**

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7
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