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Best Practices in Periodic Reviews of Participant Directed Retirement Plans

Among the duties of a retirement plan fiduciary is the duty to monitor the administration of the plan and to assure that policies and procedures are in place to minimize the risk of errors and deficiencies. While monitoring is important in all retirement plans, it is especially important in defined contribution plans, like 401(k) and profit sharing plans, that permit participant investment direction of accounts. Most often, this oversight is exercised through periodic meetings involving representatives of the plan sponsor, the internal plan fiduciaries (e.g., officers or employees who are serving as members of the plan administrative committee or as trustee), legal counsel, and the plan’s investment advisor and other service providers (e.g., the third party administrator, CPA, and investment recordkeeper). In this *Benefits Commentary*¹, we will summarize best practices for conducting periodic reviews of defined contribution plans that permit participant investment direction from investment options selected by the plan sponsor or other plan fiduciary.²

Due Diligence

The first order of business is to delegate responsibility for keeping minutes of the meeting(s) and compiling the documentation to be maintained in the fiduciary minute book or due diligence file. Under applicable law, plan fiduciaries are to be judged not on the outcome but rather whether they conducted an appropriate investigation and took action or made decisions based on the best information available at that time. In other words, plan fiduciaries are not guarantors and are to be judged on whether they engaged in a prudent process. The failure to maintain good written, contemporaneous records of the

¹ The focus of this *Commentary* will be on defined contribution plans subject to Title I of the Employee Retirement Income Security Act of 1974, as amended (or “ERISA”), the federal law governing retirement plans. This includes most retirement plans other than governmental plans, plans of churches or church conventions that have not elected to be subject to Title I of ERISA, and plans covering only a sole business owner, a sole business owner and his or her spouse, a self-employed individual, or self-employed individuals and their spouses (so-called “owner only plans”).

² The frequency of reviews will depend upon the facts and circumstances. Although it may seem somewhat counterintuitive, smaller plans may need more frequent reviews than larger plans, primarily to determine if the size of the plan has grown sufficiently that the plan may take advantage of less costly alternatives, such as a less expensive mutual fund share class or an unbundled arrangement – where all plan services are not provided by the same party or related parties.

actions taken and the decisions made could be fatal to establishing the requisite procedural prudence and therefore expose the fiduciaries to personal liability.

Meeting Preparation

Sometimes the internal plan fiduciaries and representatives of the plan sponsor will need to meet prior to the meeting with the investment advisor and the other plan service providers. Such a meeting may be helpful, for example, to refine the issues for discussion with the plan's investment advisor and other plan service providers, such as follow-up items from the most recent review, or to consider matters that need to be considered confidentially, such as a candid discussion of the reasonableness of the compensation being paid or the prudence/desirability of utilizing independent benchmarking sources or a request for proposals with respect to one or more of the current plan service providers. In many cases, however, an advance meeting is not needed. Regardless of whether an advance meeting is held, the internal plan fiduciaries and plan sponsor representatives should review the minutes of the most recent periodic reviews to ascertain if there are matters from those meetings that have not been completely resolved. In addition, the plan fiduciaries will need to communicate to the plan's investment advisor and other plan service providers the particular items that need to be covered at the meeting, preferably well in advance of the meeting.

Discussion Items

Typically, the investment advisor will lead the meeting and will start with an economic and financial market overview. That portion of the meeting can and should be abbreviated in many cases as it usually covers matters with which the plan fiduciaries are generally familiar through the media and other sources. Alternatively, it may be appropriate to defer that discussion until the latter part of the meeting. In our experience, the participants in the meeting usually have limited time availability so a lengthy discussion of economic and market issues takes away from the more important issues to be discussed, specifically³:

Fiduciary Status:

- At the outset of the meeting, each of the plan service providers should explain their status as an ERISA fiduciary and the extent to which the service provider is relieving the internal plan fiduciaries and the plan sponsor (and its officers and employees) of fiduciary responsibility under the plan. This assures there is a clear understanding of the relative responsibilities with respect to the plan.

³ The items listed are "best practice" items for consideration at the meeting. A number of them involve strategies for helping participants with their "retirement readiness," which is not a fiduciary obligation under current law but nonetheless a best practice.

Investment Performance Review:

- Comparison of fund performance to appropriate benchmarks.

Fees and Expenses Review:

- Identification of all fees and expenses being paid from plan assets, directly or indirectly, the recipient of those fees and expenses, the services being received in exchange for those fees, and the extent to which the service provider is assuming responsibility for fiduciary duties under the plan.
- Comparison of the fees and expenses to appropriate benchmarks.
- Confirmation of the reasonableness of the investment fees and expenses, including confirmation of the reasonableness of the mutual/investment fund share class utilized (i.e., the same investments and level of services are not available in a less expensive share class).
- Confirmation of the reasonableness of the fees and expenses of the recordkeeping platform utilized.
- Confirmation of the reasonableness of the fees and expenses attributable to the administrative services provided (e.g., Form 5500, annual accountings, etc.), especially if those fees and expenses are borne by participant accounts.
- Consideration of the appropriateness of using revenue sharing to pay recordkeeping and administrative expenses and consideration of reasonably available alternatives.
- Confirmation of the appropriateness of fee and expense allocation among participants and consideration of reasonably available alternatives.

Review of Mutual/Investment Fund Lineup:

- A review of the factors impacting whether changes in the investment funds are needed (e.g., level of diversification; style drift; fund gaps or overlaps; changes affecting a fund manager [e.g., change in personnel, regulatory investigations, pending legal matters, threatened or actual changes in the manager's financial condition, etc.]; number of funds offered; applicable fees and expenses; adherence to parameters of the investment policy statement, etc.).
- Prudence of utilizing a default investment alternative (if not presently used).

- Appropriateness of the fund(s) used for the default investment alternative (if applicable).
- Appropriateness of adding target maturity and/or risk-based allocation funds or models (if not presently used).
- Appropriateness of continued use of a stable value fund (if applicable).
- Appropriateness and feasibility of adding passively managed investment and ETF options (if not presently used).

Deficiencies Noted by Demographics Review and Consideration of Additional Educational Efforts:

- Review of plan participant behavior to identify deficiencies and ascertain if more targeted educational efforts are needed (e.g., participants invested solely in a single conservative investment fund; participants invested in a target maturity fund or a risk-based allocation fund and one or more other funds; recordkeeper website usage; aggregate balance in conservative investment funds; average number of funds per participant; participation and contribution rates by age and job classifications; participant loan feature usage; use of participant advice or automatic rebalancing features; etc.).
- Prudence and desirability of adding an independent participant advice program (if not presently used).
- Desirability of additional educational efforts and/or revisions to existing participant disclosures, such as disclosures for target maturity funds.
- Desirability of adding an automatic enrollment feature, with or without a periodic “escalator” in the amount automatically deferred.
- Desirability of, and ability to add, an automatic investment rebalancing feature.
- Desirability and feasibility of additional educational efforts to focus participants on the importance of retirement savings and periodically measuring the likelihood of meeting their retirement goals, such as adding account earnings projections to participant statements (to illustrate the rate of growth of the participant’s account at current contribution rates).
- Desirability and feasibility of using employee or participant satisfaction surveys to help identify areas for improvement.

Matters Required by the Plan Committee or Fiduciary Charter (if applicable)

Follow-Up Matters from Most Recent Review (if any)

Problems with Service Providers and Problems Identified by Plan Fiduciaries, Plan Sponsor Personnel, or Participants

Administrative Matters:

- Confirmation that all required participant disclosures (e.g., summary annual report, summary plan description, annual fee and expense disclosure, safe harbor 401(k) contribution notice, default investment notice, etc.) are being timely made and properly documented.
- Confirmation that all required nondiscrimination testing is being timely performed and required governmental filings have been made.
- Review of existing administrative policies and procedures (if needed).
- Confirmation that all required plan amendments have been timely executed.
- Confirmation that all administrative forms have been updated to reflect plan amendments and changes in the law.

Review of Upcoming Plan Amendments and/or Changes in Administration

Review of Upcoming Legislative or Regulatory Changes

Consideration of Advisor Recommendations for Enhancements or Improvements, including changes to the plan's investment policy statement (if applicable)

Concluding Thoughts

Often, the plan's investment advisor will use his or her "standard" agenda in leading the meeting. Plan fiduciaries cannot simply play a passive role in the meeting; instead, they must assure that the required review items are addressed and, most importantly, assure that those matters adequately documented in writing. Plan fiduciaries should not assume that they know the answers but rather need to ask questions even if the answers may on the surface appear to be obvious. Likewise, plan fiduciaries cannot let the fear of appearing "dumb" or "uninformed" deter them from asking questions. As the court said in a famous ERISA case, "a clean heart and an empty mind" are no defense to a claim of breach of fiduciary duty.

A subsequent meeting outside the presence of the investment advisor and other plan service providers may be needed for further discussion of the materials provided at the meeting. Frequently, the plan's investment advisor will provide a booklet or materials

about the plan and its investments at the meeting that are much too voluminous to be covered in any meaningful way during the scheduled time. Plan fiduciaries should not only consider what was discussed at the meeting but should also review in more detail the materials provided as what was *not* highlighted from those materials during the meeting may be more enlightening than what was specifically discussed. Simply filing the meeting materials in the due diligence file or the fiduciary minute book without further review could come back to haunt the fiduciaries.

In most cases, the plan fiduciaries will need a follow-up meeting to address purely internal matters as well as items that are not completely resolved in the meeting with the investment advisor and service providers. The failure to address follow-up matters is potentially more problematic than the failure of the fiduciaries to have considered them in the first place.



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