Retirement plan governance guide for plan sponsors

How to create a sound structure and prudent process
Introduction

Plan governance is a broad concept

It includes establishing and documenting the roles, processes and procedures that will guide all parties in establishing and administering the plan and managing its assets. It also includes the fiduciary responsibilities defined by the Employee Retirement Income Security Act of 1974 (ERISA), a set of stringent requirements for many who oversee retirement plans in the United States.

There is no perfect governance formula or structure that works best for every plan. As the plan sponsor, it’s up to you to determine the governance structure and formula that work best for your organization. This is a critical part of providing a retirement plan. Good plan governance not only helps a retirement plan be successful, it also encourages positive outcomes for participants, which is a primary goal for many retirement plans.
Those lawsuits, while unfortunate, demonstrate why good plan governance is so vital. A robust governance structure and good governance practices can help you reduce your plan’s litigation risk and improve your chances of prevailing in the event of an audit, litigation or regulatory inquiry.

Good governance focuses on the way fiduciaries (and others) carry out their duties to a retirement plan. It’s important for everyone who works with the retirement plan — at all levels in the organization — to understand their role in the governance process. That process is the key. Showing that your actions followed a prudent, well-defined and well-documented process improves the likelihood of complying with laws and regulations and is often weighed more heavily in litigation than realized outcomes.

Nonetheless, good governance will never be able to prevent everything that could negatively impact retirement plan outcomes. For example, an economic downturn or a natural disaster could affect plan assets in ways that had nothing to do with the design of the retirement plan. However, with a good governance structure in place, plan sponsors and fiduciaries have the guidance they need to make prudent decisions and successfully manage the plan even during negative events. It begins with that knowledge and understanding of how to govern the plan. The main objective is prudent action.

With so many things beyond a fiduciary’s control, why would they not want to put themselves in the best possible position to control the things that they can?

Note: ERISA fiduciary rules apply to most retirement and welfare plans. However, governmental plans, some church plans and unfunded plans that cover only management and highly paid employees (such as “top-hat” plans or nonqualified plans) are not subject to most of the stringent fiduciary requirements of ERISA. Although this guide was written for retirement plans that are subject to ERISA, all plans can benefit from integrating a good governance structure into their larger benefits program.
Governance overview and structure

Three functions of plan governance

Woven into the framework of the governance structure are responsibilities for everyone who works with the retirement plan. Those responsibilities — and their associated actions and decisions — can be divided into three general categories:
Settlor function

The term “settlor” describes someone who creates and establishes the terms of a plan. At its simplest, the settlor’s role is to act in the best interest of the organization when it comes to governing the plan. Settlor decisions are business decisions, instead of fiduciary decisions; individuals making these settlor decisions consider the interests of the employer and not necessarily those of the plan participants.

Fiduciary function

Put simply, the fiduciary’s role is to act in the best interest of the plan’s participants, that’s what the fiduciary duty of care requires: loyalty to plan participants’ interests first.

Someone is a fiduciary under ERISA “to the extent” the person:

- Exercises any discretionary authority or discretionary control respecting management of the retirement plan, or exercises any authority or control over the management or disposition of the plan’s assets
- Renders investment advice for a fee or other compensation (either direct or indirect), with respect to any plan assets (including real estate, etc.), or has any authority or responsibility to do so
- Has any discretionary authority or discretionary responsibility in administering the plan

An action constitutes “investment advice” when it meets all the criteria of this five-part test:

1. It provides the value of investing in securities or other property, or makes a recommendation or purchase or sale of security or other property;
2. It is made on a regular basis;
3. It is based on mutual agreement or understanding;
4. It is the primary basis for an investment decision; and
5. It is individualized — tailored — to the needs of the plan.

“To the extent” means that a person could be a fiduciary regarding some aspects of the administration of the plan or its investments, but not others.

1 For more information on the five-part test for investment advice, see ERISA Regulations 250996-1 Interpretive Bulletin.
Ministerial function

Ministerial acts are those that do not involve any discretion or decision-making responsibilities and therefore are not settlor or fiduciary. Individuals in the ministerial function act on the direction of the plan fiduciary and follow the terms of the plan. Sample actions include determining eligibility, calculating service or compensation, and maintaining records.

Fiduciaries should be aware of their status as a fiduciary as well as all their actions regarding the plan. The two paths to a person becoming a fiduciary are either through appointment or by taking certain actions regarding plan management and administration. That means an individual can accidentally and knowingly become a fiduciary. To help prevent someone from accidentally becoming a fiduciary, it helps to have a clearly delineated fiduciary structure, prudent and attentive procedures for appointing fiduciaries and an understanding of responsibilities to the retirement plan. Individuals who are not typically considered fiduciaries include attorneys, accountants, consultants and individuals who provide purely administrative functions.

Types of fiduciaries

In your retirement plan document, ERISA requires that you identify a “named fiduciary.” The named fiduciary is responsible for administering the plan and managing plan assets. In addition, a named fiduciary is responsible for providing direction to a directed trustee (if the plan has a directed trust) and may delegate its responsibilities to another fiduciary, who is not a named fiduciary. However, the named fiduciary cannot delegate away all fiduciary responsibilities and has a duty to monitor the fiduciary or service provider to whom the responsibilities have been delegated.

A non-fiduciary who performs a fiduciary function is an accidental fiduciary. A good risk management technique is to identify all individuals and entities that provide services or perform tasks related to the plan and identify each as a fiduciary or non-fiduciary.

A person in a ministerial role must not exercise discretion. The making of policies or interpreting the plan document would make them a fiduciary. Thus, they must be diligent about not exerting control over the administration of the plan or the management of plan assets.
The employer, an individual, or a committee typically serves as the named fiduciary. An important part of determining the fiduciary structure for your plan involves identifying the named fiduciary and understanding the responsibilities of the role. Often, plan sponsors prefer not to specifically identify the named fiduciary by name or role in the plan document because a personnel change of the named individual would require an amendment to the plan document. Instead, the plan document often provides a description of the procedure for appointing the named fiduciary.

In addition to the named fiduciary, there are other fiduciary roles that will support the plan. The most common types of fiduciaries are the following:

**Investment adviser**

According to ERISA Section 3(21), a person is deemed an investment advice fiduciary when they render advice or provide recommendations for a fee regarding the purchase or sale of securities or other property for a plan. Although the investment advice fiduciary may aid the named fiduciary, the named fiduciary still bears the ultimate responsibility for selecting and monitoring investment options. An investment adviser should acknowledge in writing that they have assumed ERISA fiduciary status with respect to the plan, not only to include with the plan documentation, but also to indicate they understand the responsibilities that the role entails.

**Investment manager**

An “investment manager” is defined in ERISA Section 3(38) as a fiduciary (other than a trustee or named fiduciary) who:

- Has the power to manage, acquire or dispose of any asset or a plan,
- Is either a registered investment adviser (RIA) under the Investment Advisers Act of 1940, a bank or an insurance company, and
- Has acknowledged in writing that he or she is a fiduciary with respect to a plan.

The named fiduciary is relieved of liability resulting from any act or omission of the investment manager if the appointment of an investment manager is executed in accordance with the terms of the plan. However, ERISA’s standards of fiduciary conduct continue to apply to the named fiduciary’s selection, appointment and monitoring of the investment manager.
ERISA requires (with certain limited exceptions) that a plan’s assets be held in trust by one or more trustees. Unless the trustee is subject to the direction of another party, such as plan participants, the plan trustee is the person recognized as having exclusive authority and discretion over managing and controlling plan assets. The plan sponsor could choose to delegate responsibility for appointing a trustee to a named fiduciary. The main advantage to delegating this responsibility is that it minimizes or eliminates the board’s or officer’s exposure to fiduciary liability in connection with the selection of the trustee.

Under ERISA Section 3(16), the plan administrator has discretion over the administration of the plan and, as such, is a fiduciary. Some plan administrators will outsource a portion of the non-investment related fiduciary responsibilities to third parties. These independent fiduciaries are referred to as 3(16) fiduciaries. Generally, a 3(16) fiduciary will accept specific responsibilities of the plan administrator and receive compensation for providing these services. Although 3(16) fiduciaries are subject to the ERISA fiduciary standards of conduct and are liable for their actions (and inaction), it is important to note that the plan administrator cannot delegate away all their fiduciary responsibilities and has a duty to monitor the 3(16) fiduciaries.

Delegating fiduciary responsibilities

Appointing and monitoring fiduciaries starts at the top of the organizational chart, which could be with the owner of an organization or its board of directors. The appointment of another fiduciary is a fiduciary act, and with it the duty to monitor the appointee. Commonly, the board of directors delegates/appoints the fiduciary responsibilities to the CEO or another officer, who will either act as the named fiduciary or will further delegate/appoint the responsibilities to another individual or committee. Each layer of delegation in the governance structure creates a responsibility for the delegator to monitor the individual to whom the responsibilities have been delegated.

As already mentioned, a fiduciary cannot delegate away all fiduciary responsibilities. And it’s important to document the activities throughout the year as a means for the overseeing fiduciary to examine whether a prudent process has been undertaken and duties have been properly discharged under ERISA. Annual reports can be a beneficial tool for documenting and monitoring the process.

How to delegate responsibilities is one of the foremost decisions that a plan sponsor must make regarding governance structure.

3 Generally, exceptions include assets of a plan held by an insurance company and contracts.
Retirement plan committee

Many retirement plan sponsors decide to establish a committee to handle a portion of the fiduciary or settlor responsibilities. Although administration and investment committees are common, ERISA does not require that a named fiduciary’s duties be discharged to a committee. In addition to serving in a fiduciary capacity, some plan sponsors choose to establish a settlor committee, which is charged with reviewing plan design issues and recommending changes to the plan. A settlor committee could serve in a purely advisory role or it could be delegated amendment authority over all plan amendments or just those that meet established criteria as decided by the organization.

Ultimately, you’ll need to decide whether to create a retirement plan committee. Larger organizations are more likely to establish committees to handle the retirement plan fiduciary responsibilities than smaller ones. Smaller organizations are more likely to delegate responsibilities to an individual in lieu of a committee. But an organization’s size isn’t the only factor to consider.

From a risk mitigation perspective, a retirement plan committee is beneficial for formalizing and centralizing plan decisions. Also, a larger decision-making body usually equates to more knowledge on the committee, which should lead to better decisions.

The board of directors may reserve the right to amend the plan regarding any changes of material negative cost.4

To foster better decision-making, consider these attributes of strong committees:

- Diversity
- Multiple perspectives to prevent groupthink
- People to represent specific skill sets, including finance, human resources, operations, legal, accounting, and knowledge of financial markets
- An odd number to avoid tie votes
- Plan for rotating committee members, if necessary

Because larger committees can lose effectiveness, some plan sponsors have multiple committees, each with different responsibilities as part of their governance structure.

4 The term “material” refers to something being relevant and significant — the common legal usage.
5 For the remainder of this guide, retirement plan committee could refer to any of these capacities.
Members of a committee should be capable of performing up to the standards of a knowledgeable professional. Should individuals in the C-suite (such as the CEO, CFO, or CIO) be on the committee? On one hand this group of individuals will likely have the knowledge and requisite expertise, but on the other hand their presence may hinder productive discussion and dialogue. In addition, someone from the C-suite may be too busy to attend every meeting and to do the necessary preparatory work.

Some larger organizations with multiple subsidiary employers or locations may want representation from the various sub-entities. These individuals can provide insights on opinions from employees at the different areas. Most employers who structure their committee this way will have a rotation, which creates a revolving door of options and insights.

Another decision will be whether in-house legal counsel will have a presence on the membership of the retirement plan committee. When in-house counsel acts as a member of the committee, it should be assumed that any communication from the attorney to other committee members regarding committee business does not fall under attorney-client privilege. Ultimately, you’ll need to decide whether to receive insights from an attorney acting as counsel to the committee or from an attorney acting as a committee member.

A copy of the formal documentation for appointing the individuals or committee members should be maintained in the plan records. Once appointed to fiduciary status, individuals should be provided a description of their appointed position, expectations and overall responsibilities. Everyone who accepts an appointment should sign a written confirmation accepting the position and acknowledging the role with respect to the plan, its participants and other fiduciaries.

Appointment as the “named fiduciary” or membership on a fiduciary committee should not be used as a development tool or a mostly symbolic position.

Individuals selected as committee members should be those willing and best able to perform the applicable fiduciary functions. Individuals are prohibited from the fiduciary role if they have been convicted or imprisoned because of:

- Any felony involving abuse or misuse of such person’s employee benefit plan position or employment
- Any felony arising out of conduct of the business of a broker, dealer, or fiduciary
- Income tax evasion
- Any felony involving larceny, theft, robbery, or extortion of funds or securities
- Conspiracy or attempt to commit any such crimes
- Any other crimes described in ERISA
Understanding responsibilities

Fiduciary responsibilities

ERISA imposes substantial responsibilities on fiduciaries who manage, control or otherwise have the authority to invest plan assets or to operate and administer the plan.

Fiduciaries are subject to heightened standards of conduct, some have even called it the highest standard of care in American law. The motive for these stringent requirements is to protect the retirement assets of plan participants. A fiduciary has the duty to act solely in the interest of plan participants and beneficiaries and must comply with the following:

- Exclusive benefit rule
- Prudent person rule
- Diversification rule
- Duty to follow plan terms

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Exclusive benefit rule  A fiduciary must act solely in the best interest of participants and beneficiaries for the exclusive purposes of providing retirement benefits and paying only seasonable plan fees. The exclusive benefit rule is designed to avoid conflicts of interest and make sure that the plan has the fiduciary’s full, selfless attention. Courts have interpreted this to mean that fiduciaries must act with complete and undivided loyalty to the participants and beneficiaries.

Prudent person rule  A fiduciary should act with the care, skill, prudence, and diligence of a prudent person who is knowledgeable and acting in like capacity and under similar circumstances. When it comes to investment selection, this is sometimes called a prudent expert rule because fiduciaries are measured by the standard of a knowledgeable investor. In other words, a good faith effort without investment knowledge is not enough.

Diversification rule  Diversifying the plan’s investments helps minimize the risk of large losses. When choosing investment options, a fiduciary should select investments with different objectives and risk/return characteristics. For participant-directed plans, a broad range of investment options should be offered to help participants meet their goals and risk tolerances. Note that this rule may not apply to certain plan types holding qualified securities such as an employee stock ownership plan.

Duty to follow plan terms  Following a plan document that is consistent with ERISA is important for qualified retirement plans. If a plan document is in violation of ERISA rules, fiduciaries are required to override the plan document to ensure their plan is in compliance with the laws and regulations.

The appointing fiduciary should identify documents that give authority and allocate duties to the fiduciary. The fiduciary may have been assigned duties from any of the following: the plan document, ERISA, the committee charter statement and other governing documents that may be in place (e.g., resolutions, policies such as the investment policy statement and procedures adopted by the retirement plan committee, trust document, etc.).

It’s important to provide new committee members with information about their new responsibilities as well as training for their new role, including being subject to the standards of an ERISA fiduciary. In addition, new committee members should be educated on the entire governance structure. Ongoing training with periodic refreshers is also beneficial.

The appointing fiduciary should designate at least one individual to serve as chair of each retirement plan committee. The individual who was named as chair of a retirement plan committee will likely be the one to oversee the initial process of establishing the committee infrastructure and charter statement.

If a fiduciary lacks experience, the fiduciary should seek advice from a knowledgeable expert.

Fiduciaries who violate ERISA can be held personally liable when they act for interests of individuals other than those of the participants and beneficiaries.
Retirement plan committee infrastructure and charter statement

Before the retirement plan committee can begin to execute its duties, it must have a fully operational infrastructure within which to act. Duties of the retirement plan committee cannot be fulfilled until it begins to operate as a unit, meeting to address issues and carry out responsibilities. The committee should have a charter statement or similar documentation that addresses the number of committee members, the appointment process for them, the removal process, as well as what positions there will be on the committee (such as chair and secretary). The charter will also discuss the frequency of the meetings as well as whether a majority vote will be the standard. Similar to delineating the roles of chair and secretary, the charter should discuss the responsibilities of the members and authorize the committee to delegate responsibilities.

Here are some points for developing the necessary infrastructure to carry out assigned duties:

Scheduling meetings: Regular and well-organized meetings are an essential part of a prudent decision-making process. The charter statement of the retirement plan committee should require periodic meetings.7 The first meeting of the retirement plan committee should be scheduled as soon as possible after the committee is formed, for several administrative details will need to be addressed.

Selecting a secretary: Typically, the secretary is responsible for taking minutes at meetings, recording actions of the committee and retaining committee records. The secretary should be familiar with the terms of the plan document and the committee charter and should guide the committee from a procedural perspective. A secretary of the committee should be appointed unless the charter already specifies who will serve in this role.

Helpful tips

What to include in your retirement plan committee’s charter statement

- Meeting schedule (frequency)
- Role of the secretary
- Requirements for committee action (e.g., majority vote)
- Role of legal counsel
- Roles that may assist the committee
- Process for communicating with other committees and potential joint-committee action, if multiple committees exist
- Appoint agents to carry out committee actions
- Identify co-fiduciaries
- Identify potential conflicts of interest
- Identify required reports
- Rules for record retention
- Charter review schedule (frequency)

7 If the charter statement says that a retirement plan committee shall meet according to a specific timeframe (for example quarterly or monthly), it is important that the meetings are held on schedule. A failure to do so could constitute a fiduciary breach.
**Actions of the committee:** It’s important to determine how decisions will be made (e.g., majority vote, etc.). Also, for logistical purposes, some committees will want to allow for decisions to be made outside of the formal meetings. Proper documentation should be consistent with the procedures and show “when” and “how” committee action without a meeting is permissible.

**Legal counsel:** Each committee should arrange for legal counsel. It is not uncommon for counsel to be engaged in providing legal advice to both the plan sponsor regarding the settlor function and advice to committees regarding the administration of the plan and management of the plan assets. This is an efficient structure. However, the interests of the settlor and committee, as fiduciaries, may differ at times, giving rise to conflicts. It is important to be aware of who is receiving the legal advice: Is the attorney providing advice in a settlor or fiduciary capacity? Important considerations of the arrangement are attorney-client privilege, billing and conflict of interest issues.

In a non-fiduciary role, legal fees should be paid by the plan sponsor, not from plan assets. Paying expenses from the plan may violate ERISA. To the extent that legal fees are being charged to the plan, only fees that relate to advice provided about fiduciary issues may properly be paid from plan assets. To the extent that an attorney is providing advice to a plan fiduciary acting as such, the communications may not be privileged. Under the theory that a fiduciary is working solely for the participants and beneficiaries, a “fiduciary exception” to the attorney-client privilege may apply, and a court might permit plan participants to gain access to the advice and communications of “their” attorney, even though the advice was provided directly to the fiduciary.

**Communications among the committee and plan sponsor:** Each committee within the governance structure will need to be aware of the happenings and decisions of the other committees within the framework for various items. Although each committee will make decisions independently, receiving communications about settlor decisions could lead to efficiencies and better fiduciary decisions. For example, the decision to terminate a plan will impact the fiduciary function. Thus, a committee with fiduciary responsibilities should be aware of the activities of the settlor function and what its impact will be on the administration of the plan or management of plan assets.\(^8\)

The committee structure will be the primary influencer of how these types of communications will flow between the different entities. One possible approach is to have time set aside at each committee meeting for representatives of the plan sponsor to provide necessary information. If one or more of the committee members also performs a plan sponsor function, they should be mindful of which function their actions fall under: the fiduciary function or settlor function. Some use the analogy of what hat they are wearing at any given point in time. For example, they may convey settlor decisions wearing a plan sponsor hat and process decisions wearing a fiduciary hat.

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\(^8\)If the plan sponsor is planning to change eligibility provisions, this will need to be communicated to the administration committee so it can modify procedures to ensure the plan is operated in accordance with its terms. Likewise, if the plan sponsor is planning to make its required contribution to its defined benefit plan, this will need to be communicated to the investment committee so that committee can be prepared to invest the contribution.
**Designate employees who will assist the committee:** The plan document or the committee charter should provide that the named fiduciary may appoint individuals (including employees) to assist the committee in performing its duties via ministerial actions. Appointments should be recorded in the committee minutes or within a plan’s administrative processes and procedures. This documentation should delineate how the responsibilities will be allocated and to which individuals as well as include specific details so there is no question about the identity and accountability of the responsible person.

Ministerial acts are those performed within a framework of policies, interpretations, rules, practices and procedures established by named fiduciaries. Those acts are typically performed by service providers and/or employees of the plan sponsor. The line between a fiduciary act and a non-fiduciary ministerial act is not always easy to distinguish, and many functions may have elements of both. Those performing ministerial acts must be diligent about the functions they perform and be aware of their authority.

**The Department of Labor (DOL) has identified functions that are ministerial:**

- Application of rules determining eligibility for participation or benefits
- Calculation of service and compensation credits for benefits
- Preparation of employee communications materials
- Maintenance of participants’ service and employment records
- Preparation of reports required by government agencies
- Orientation of new participants
- Collection of contributions and application of contributions as provided in the plan
- Preparation of reports concerning participants
- Processing of claims for benefits (not including discretionary claims determinations)
- Recommendations to others for decisions relating to plan administration

To ensure that the committee receives necessary information, it’s also advisable for the committee to appoint an individual — typically a member of the human resources staff — to schedule and coordinate meetings and prepare meeting materials.

**Designate agents to carry out committee actions:** The charter should allow for the committee to authorize individuals outside of the committee to communicate and carry out decisions on its behalf. When designating agents to act on its behalf, the committee should clearly identify those individuals. Typically, agents will be a member of the human resources staff. Since third parties to the retirement plan (such as service providers) will likely want assurance that they are taking instructions from an authorized individual, the committee secretary should (1) prepare a certification of the committee’s action, (2) identify the authorized persons and (3) specify the limits of their authority.

*See Federal regulations § 2509.75-8.*
**Identify co-fiduciaries:** The committee should identify all other fiduciaries. The list will help the committee manage co-fiduciary risk as well as help those individuals with responsibilities to monitor other fiduciaries to whom responsibilities have been delegated.

**Identify potential conflicts of interest:** Committee members must disclose any conflicts of interest and any potential conflicts of interest to the entire group. Conflicts of interests may result from personal or business activities outside of the employment relationship or directly related to employment. Conflicted members should recuse themselves from any decision when conflicts (or even potential conflicts) are present. A fiduciary must act in the best interests of plan participants and beneficiaries. Committee members should be aware how this ERISA best interest standard interacts with any conflicts of interest.

**Record retention:** Documentation of a prudent process can be a fiduciary’s best friend in the event of litigation. The committee secretary or someone else on the committee should be responsible for retaining committee records and meeting materials. ERISA requires a six-year retention period for materials related to filing reports and certifying information.\(^\text{10}\) However, records for benefit calculations should be retained until no longer needed.\(^\text{11}\) Also, prohibited transaction exemptions can have their own required record retention time periods for certain documents. A sufficiently long retention period should be determined for other materials, such as information around investment decisions.

It is important that retention policies are followed and that materials are destroyed at the end of the period. Courts often view benefit plans as “contracts” for determining the statute of limitations that apply to lawsuits.\(^\text{12}\) At a minimum, a committee should ask its counsel about the statute of limitation for contract actions in the states in which participants and beneficiaries live. It may be preferable to not destroy documents while claims can still be brought. Documents generated and/or stored electronically are subject to the same record retention requirements as paper documents.

**Reports to appointing fiduciary:** The fiduciary who appoints the committee members is responsible for monitoring the committee and its performance as the named fiduciary. Thus, the appointing fiduciary will need enough information to evaluate the job being done. The committee should provide the appointing fiduciary with materials such as a summary of meeting minutes on the committee’s activities. Some committees will provide an annual report to the appointing fiduciary. The charter should address this issue and the committee should discuss and follow through on how and when it will provide materials to the appointing fiduciary.

\(^{10}\)See ERISA Section 107.

\(^{11}\)See ERISA Section 209.

Committee members must follow governing documents. The only exception is when ERISA (or other federal laws and regulations) clearly contradict these demands. In these instances, governing documents should be reviewed for the appropriate legal requirements and updated if necessary.

**Fiduciary review of charter:** If the charter provides that the committee should review the committee charter periodically (such as annually) and make recommendations to the plan sponsor, the committee should make provisions for doing so.

**Joint committee actions:** If a retirement plan has multiple committees, instances may arise where they’ll need to coordinate actions. For example, reviewing and selecting bundled service providers (e.g., investment and administrative services) would necessitate information-sharing. Some charters provide that all fiduciaries and committees have an annual meeting to discuss the retirement plan and its overall governance structure and processes. In times of hardship, such as economic uncertainty or business difficulties, more frequent meetings may be beneficial.
Operational structure

A retirement plan document must comply with relevant laws and regulations, and individuals working with a retirement plan must operate the plan according to the written plan document as well as other governing rules.

Failure to operate the plan correctly can result in operational errors and fiduciary breaches. Successful retirement plans have operational structures that keep the plan within the guardrails of the laws and regulations as well as within the boundaries of the plan provisions.
Regulating bodies
The Internal Revenue Code (IRC) and the Employee Retirement Income Security Act of 1974 (ERISA) are the two main sections of United States law that govern retirement plans. Subsequently, the Internal Revenue Service (IRS) and the Department of Labor (DOL) are the two main regulators. Both make sure that laws and regulations are being followed — the DOL, which focuses on ERISA and emphasizes protecting plan participants, and the IRS, which governs the IRC and focuses on collecting tax revenue.

Enforcement
A failure to uphold ERISA fiduciary duties can be costly and result in substantial negative consequences, especially when bad behavior is involved.

Potential penalties for failing to operate the plan correctly include:
- Personal liability
- Disgorgement of profits and self-reporting excise tax
- Co-fiduciary liability
- Fines, penalties and correction costs
- Litigation
- Reputational risk
- Removal from fiduciary position and ban on future fiduciary service
- Imprisonment

Depending on the ERISA violation, the participants and beneficiaries who are impacted (or the DOL on behalf of participants) may be entitled to seek relief from the courts and be made whole by the wrongful fiduciaries. Fiduciaries may also seek relief under ERISA, either on behalf of the plan or to address poor conduct of a co-fiduciary. Other parties may seek non-criminal actions to remedy ERISA violations with civil claims, and the federal government (usually via DOL investigations) can bring criminal actions.
The DOL requires certain service providers to disclose specific information to plan fiduciaries, including compensation they or their affiliates have earned with respect to service provided to the plan. The common prohibited transaction exemption in ERISA Section 408(b)(2) requires a fiduciary and service provider to comply with these disclosure rules. If these requirements are not met (for example, when compensation paid to service providers is not reasonable), contracting for plan services and providing those services are nonexempt prohibited transactions and can result in significant liability to both the plan fiduciary and the service provider.

**Document authority**

Each retirement plan that is subject to ERISA must be established and maintained pursuant to a “written instrument” that describes the structure of the plan and the way it is to be administered.13 A retirement plan document must specify its terms as well as how it can be amended in the future. Typically, amendment authority will be with the board of directors, officers of the organization or a settlor committee (if part of the governance structure), which is established to handle the settlor functions of the plan. Unless the board will be responsible for all amendments, the governing documents should note this delegation. Amendments from unauthorized individuals are targets for litigation.

It’s vital to recognize the important corporate governance responsibilities of the board of directors, the CEO and other officers under corporate law (and not under ERISA). Broadly, the board is responsible for overseeing the operation of the organization, giving it guidance and protecting the stakeholders’ interests. For “for-profit” businesses, the board has a fiduciary duty under corporate law (and not under ERISA) to the shareholders of the company and, for that reason, may feel it’s appropriate to maintain some role in the establishment and amendment of a retirement plan.

**Examples of Retirement plan legal actions:**14

- Participants and beneficiaries may bring actions against the plan administrator for violations of reporting and disclosure requirements of ERISA. Catalysts for this litigation may be a failure to provide the summary plan description, the latest annual report, plan documents or participant statements.
- Participants and beneficiaries may sue the plan to recover benefits due. They can obtain a declaratory judgement of an entitlement to benefits to compel the plan administrator to pay benefits.
- A participant, beneficiary, fiduciary or the DOL may sue a fiduciary to recover plan losses or fiduciary gains resulting from the fiduciary’s breach of its duties. If the suit is successful, the fiduciary will be personally liable to pay any losses to the plan resulting from the breach and to restore to the plan any profits resulting from the breach.15
- A participant, beneficiary or fiduciary may bring a suit against a fiduciary or non-fiduciary to recover individual participant’s or beneficiary’s losses. If the suit is successful, the fiduciary would be personally liable to pay any losses to the plan resulting from the breach and to restore to the individual any profits resulting from the breach.

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13 See ERISA Section 402(a)(1).
14 See ERISA 502(a).
15 In certain situations, fiduciaries may also be subject to other relief as the court deems appropriate.
Day-to-day decisions of most organizations are made by the officers of the organizations and it is not, generally, the role of the board of directors to manage at such a granular level. A proper balance needs to be found so that the board can feel comfortable it is performing its oversight and guidance responsibilities while not being burdened with plan amendments that are more technical and compliance-oriented.

One common approach is for the board to retain exclusive authority to adopt plans and plan amendments that have a material negative cost impact to the organization and to delegate the document authority for the adoption of plans and amendments that do not have such a cost impact. What is “material” will vary for each organization. The term “material” can be defined in the plan document or it can be left undefined with discretion delegated to the CEO or other officer. The size of the organization is a practical consideration. For larger organizations, the board is less involved in the day-to-day operations of the organization, which increases the importance of authorizing delegates to act. For smaller organizations, members of the board are more likely to be actively involved in the day-to-day operations of the plan and have their own amendment authority.

An alternative is to establish a settlor committee. Depending on the governance structure, a settlor committee could serve in a purely advisory role or be delegated amendment authority for all amendments or just those that meet established criteria.

Goals and operations
The design of the retirement plan should consider the goals and objectives of the plan sponsor. **Common goals for plan sponsors are the following:**

- Help employees save for retirement
- Recruit, reward and retain talented employees
- Provide retirement benefits within the cost constraints of the organization
- Provide retirement benefits competitive with peer organizations
- Include succession planning for the organization
- Policies are developed to assist non-fiduciaries
- All governing documents are reviewed and monitored

Either the retirement plan committee or the named fiduciary review the plan document periodically, considering the goals and objectives of the plan sponsor as well as other considerations. Policies, procedures and operations should all be consistent with the plan document. **The retirement plan committee should make sure of the following:**

- The plan document is followed
- Procedures around the plan document are in place
- Policies are developed to assist non-fiduciaries
- All governing documents are reviewed and monitored
Administering the plan
A retirement plan must operate in accordance with its plan document and ERISA. Some plan sponsors establish an administration committee to oversee plan administration and act as the plan administrator. It’s more common though to have one retirement plan committee that handles the responsibilities of the plan administrator along with other fiduciary responsibilities. Although the task of operating the plan may appear simple, the plan administrator is responsible for virtually every aspect of operating, maintaining, and administering the retirement plan.

It’s a good idea to inventory the duties and responsibilities of the retirement plan committee, other fiduciaries and other non-fiduciaries. Whether an individual or structured as a committee, the plan administrator’s “inventory” of duties will likely yield a very long list. The plan administrator may be required to adopt policies (e.g., a loan policy), adopt procedures (e.g., how participants may enroll in the plan) or ensure that required nondiscrimination testing is accurately completed on a timely basis. This lengthy list does not relieve the plan administrator of the responsibility for ensuring that each of its duties is performed in accordance with the fiduciary standards of conduct.

The plan administrator will typically rely on human resources staff and non-fiduciary service providers to carry out these day-to-day responsibilities for ministerial functions. Human resource staff and service providers engaged on a non-fiduciary basis will not be considered fiduciaries if they are merely following plan terms, policies and procedures developed by the plan fiduciary. However, a non-fiduciary service provider can’t create the policies and procedures. Accordingly, the plan administrator or committee must develop policies and procedures to assist with the ongoing administration of the plan and management of plan assets.

ERISA is not the only source that allocates specific duties. The terms of the plan document also contain provisions dictating how the plan is to be operated and the IRC will have requirements as well. Thus, the plan document and ERISA impose many duties on the plan administrator and some guidance as to how to perform them. It’s the plan administrator’s responsibility to ensure those provisions are followed.
Internal controls

Addressing the possibility of errors upfront and searching for existing errors instead of waiting for them to be uncovered goes a long way towards minimizing the risk of mistakes. Internal controls are business processes designed to detect and prevent mistakes in a retirement plan. These controls are an essential check against mistakes and help reduce the negative consequences when plan errors do occur.

Examples of internal controls include periodic reviews of:

- Eligible employees:
  - Eligibility requirements
  - Compensation
- Excluded populations or classification of employees
- Contributions and census data
- Plan document provisions

Internal controls help ensure that operations are complete and accurate. Internal control policies and procedures can assist a fiduciary in making sure that a plan is managed prudently and operates closely to its created process. Some processes use more formal documentation, especially for operations around qualified domestic relations orders, hardship withdrawals and loans.

To determine what internal controls are most appropriate for the retirement plan, a plan committee should weigh the benefits of internal controls alongside the time and resources required to perform them.

Audits

To make sure that service providers are acting appropriately and in accordance with the terms and conditions under which they were hired — and that their processes are still acceptable — the plan administrator should consider conducting a periodic audit.

For certain retirement plans, the plan administrator is responsible for retaining an accountant to audit the financials. This auditor may or may not be the same accountant that provides day-to-day accounting services to the plan sponsor. Some accountants may also be hired to provide third-party administration or recordkeeping services. Engaging an auditor on behalf of the plan must be done solely in the interest of plan participants and beneficiaries. Accordingly, if the auditor also is engaged by the company,

An ounce of prevention is worth a pound of cure.16

16 Henry de Bracton.
care should be taken to make sure that the plan administrator is comfortable that the auditor is also qualified to perform the audit with respect to the plan.

The plan administrator should also consider a self-audit of its own actions and processes to ensure that the way the plan is being administered is consistent with its terms and relevant legal requirements.

Having effective practices and procedures to prevent compliance problems is a basic requirement to be eligible to self-correct insignificant operational errors at any time and preserve the tax-favored status of the plan without having to pay any fees. IRS agents often evaluate internal controls to determine whether to perform a focused or expanded audit. In addition, if the agent finds plan errors, the strength of internal controls is a factor in the negotiation of the sanctions/penalties.

A regulatory audit from the IRS and DOL will always be a possibility for a retirement plan. Audits conducted by regulators place a burden on plan sponsors and fiduciaries, and no matter how diligent the compliance efforts and how sound the governance structure, audits always require time and resources. Being prepared is the best defense and helps reduce the stress of an audit. In some instances, good documentation is enough to satisfy the inquiries of auditors and prevent further investigation. Thus, knowing what information to focus on can improve efficiency and result in a happier outcome. Internal controls that detect and prevent mistakes can be the reason that a regulatory audit has a smaller scope, such as a focused audit, rather than an expanded audit.
Investments and fees

The fiduciary of a qualified retirement plan has responsibilities to prudently select and monitor the investment of plan assets as well as to ensure that fees and expenses paid from plan assets are reasonable.

A failure to do so may result in a fiduciary breach and possible litigation. Fiduciaries should engage in a prudent process to select investment options and monitor them going forward. In addition, fees must be reasonable for the services being provided.
Understanding fiduciary responsibilities, especially for fees and investments, is essential for helping avoid litigation as well as for reducing the negative consequences from litigation when it occurs. Including employer stock in a retirement plan tends to increase litigation risk. Over 6,300 lawsuits were filed under ERISA in 2018. Common claims in ERISA litigation are:¹⁸

- Excessive fees
- Inappropriate investments
- Self-dealing, which is when a plan fiduciary acts in their own self-interest and not for the benefit of participants and beneficiaries

The fiduciary requirement of the prudent expert standard applies to defined benefit plans as well as defined contribution plans. Investments for defined benefit plans will often focus on each plan’s liabilities as determined by the actuary. For example, the investments of a defined benefit plan may not need to be as liquid as that of a defined contribution plan, depending on the expected timing of the liabilities. In contrast, investments for defined contribution plans with participant direction will often consist of different broad-based investments options with different risk and return characteristics that participants can select from to take advantage of different investment strategies.

**Investment committee or retirement plan committee with investment responsibilities**

Many retirement plans have a separate investment committee or a retirement plan committee that maintains the fiduciary responsibilities for the prudent selection and monitoring of investments. A well-prepared retirement plan committee has more information going into the decision-making process and uses meeting minutes and other documents to provide documentation of their prudent process. Having a committee helps alleviate risk because it should formalize investment decisions and ensure that more individuals are involved in the decision-making process. Nevertheless, larger committees should work to overcome groupthink and make sure individual committee members are not blindly following the chair but are satisfying their fiduciary obligations to the plan.


**Tasks for the committee related to plan investments include:**

- Adopt policies and procedures necessary to manage plan assets and investment managers
- Develop asset allocation policies when participants aren’t providing investment direction
- Select and monitor plan asset service providers, such as investment advisers and investment managers
- Select investment options
- Determine reasonableness of plan expenses relating to the management of plan assets
- Delegate fiduciary responsibilities
- Develop an Investment Policy Statement
Whether structured as a distinct investment committee or as a retirement plan committee with fiduciary responsibilities around investments, to be successful the committee must have a productive framework in which to operate. See the subsection “Retirement Plan Committee Infrastructure and Charter Statement” for more information.

Fiduciaries are responsible for regularly monitoring the performance of plan investments and should at least annually (or as significant events occur) review those investments. Monitoring investments on a regular basis helps to ensure the investments continue to maintain the characteristics that make them appropriate for the retirement plan, ERISA and the objectives of the retirement plan committee. Any adverse changes to the investment manager’s organization, investment process or performance results should be identified and responded to in a timely manner. A prudent process should underlie removing investments that are no longer appropriate to the plan, as well as recommending a replacement investment that is more suitable. Documentation should explain the reasons for the removal and the rationale for the replacement. Any changes will need to be communicated to participants in advance as required by the DOL’s ERISA 404(a) regulation and meet its timing requirements of 30 to 90 days in advance or as soon as reasonably practicable when unable to provide such advance notice.

For defined benefit plans, the committee determines the appropriate investments for the plan given the liabilities that are calculated by the plan actuaries. For defined contribution plans with participant direction of investments, the committee selects investment options where participants can allocate assets from their account.

Common considerations of a retirement plan committee for investment options are diversification, number of options, monitoring fees and expenses, mix of complementary investment styles and seeking expert advice. A committee must offer an appropriate number of investment options within the plan to participants. There is no correct number (no “magic number”) and different committees will have different approaches. A plan with ERISA 404(c) protection must offer at least three investment alternatives. Many committees feel that it is important for participants to be able to take advantage of different investment strategies — for example passive or active. However, too many options can lead to paralysis where participants are too overwhelmed by the number of options to do anything.

Employees of the plan sponsor who make investment suggestions and recommendations to the committee are not considered fiduciaries unless they receive direct or indirect compensation, which must be in addition to their normal compensation.
Investment policy statement

Following a comprehensive investment policy statement can be a useful tool for fiduciaries attempting to satisfy their fiduciary responsibilities, though there is no rule from ERISA that mandates maintaining an investment policy statement for a plan. If you’re keeping one, a written investment policy statement should address the prudent process for selecting and monitoring investments.

The structure of an investment policy statement will differ depending upon whether the plan fiduciary is selecting funds for a participant-directed plan, managing investment options under a profit-sharing plan with no participant-directed investments or managing investment options under a defined benefit plan. Any investment policy statement should specify:

- Quantitative and qualitative criteria for evaluating investment options, including benchmarks for measuring performance
- Events involving investment managers that will be scrutinized
- The process that will be used to monitor investment options, such as placing the options on “watch lists” or removing the options from the plan
- The role of employer stock or the self-directed brokerage account option (if either of these are available under the plan)

An investment policy statement may address the attention that will be given to fees associated with investment options, as well as other factors that may affect investment decisions. If investment advisers are helping to select and monitor investment options, the policy statement may be written to acknowledge their role and describe how they will work with the plan fiduciary. For example, if the committee has outsourced responsibilities to a 3(21) investment advice fiduciary or a 3(38) investment manager, the committee should consider adding the outsourcing in the investment policy statement. In addition to documenting a prudent process, an investment policy statement should provide a framework to guide fiduciaries in selecting and monitoring plan investment options, investment managers and the evaluation of fees.

An investment policy statement can be integral to the success of a retirement plan and may mitigate risk by providing documentation in case of litigation.

A fiduciary who lacks the education, experience and skill required to make a prudent decision regarding the investment of a plan’s assets or other fiduciary function has an affirmative duty to seek expert advice in making the decision. 19

Outsourcing responsibilities

When the committee does not have investment skills, experience or knowledge that meets ERISA's standards among its members, it should consider delegating responsibilities to outside professionals, such as a 3(21) investment advice fiduciary or a 3(38) investment manager.\textsuperscript{20} Given the knowledge level of the committee, relying on outside expertise may be in the best interest of participants and beneficiaries.

When the named fiduciary engages outside experts, such as an investment manager and/or an investment adviser, it’s important to retain an agreement covering the terms of that engagement as part of the plan records.

Investment manager

ERISA Section 3(38) defines the term “investment manager” to mean fiduciary (other than a trustee or named fiduciary) who:

- Has power to manage, acquire or dispose of any asset of a plan
- Is either a registered investment adviser (RIA) under the Investment Adviser Act of 1940, a bank, or an insurance company
- Has acknowledged in writing that they are a fiduciary with respect to the plan

A named fiduciary may appoint an investment manager, if the plan permits. Generally, an investment manager is a registered investment adviser (RIA), a bank, or an insurance company that is engaged as a fiduciary to manage certain assets of the plan and has specifically acknowledged, in writing, to be a fiduciary of the plan. Thus, a named fiduciary will be relieved of liability resulting from any act or omission of the investment manager, presuming that the appointment of an investment manager is executed in accordance with the terms of the plan. The named fiduciary’s selection, appointment and monitoring of the investment manager, however, must be consistent with ERISA’s standards of fiduciary conduct.

\textsuperscript{20}An ERISA § 3(38) investment manager should not be confused with an investment adviser. The key difference is that the investment adviser (unlike the investment manager) does not manage plan assets. An investment adviser may provide assistance, including making investment recommendations, to an investment committee, but the investment committee remains responsible for investment fund selection.
**Investment adviser**

An investment adviser — sometimes referred to as an “ERISA Section 3(21) investment adviser” — is engaged to provide investment advice to a plan fiduciary for a fee and must perform his or her responsibilities consistent with the fiduciary standards of ERISA.

ERISA Section 3(21) provides that a person will be an investment advice fiduciary where such person renders advice or provides recommendations for a fee. The adviser does not manage plan assets. Whether an adviser is a fiduciary depends on whether they meet ERISA’s functional definition of a “fiduciary.”

Someone is a fiduciary under ERISA with respect to a retirement plan to the extent the person:

- Exercises discretionary authority or discretionary control respecting plan management or exercises any authority or control respecting management or disposition of its assets
- Renders investment advice for a fee or other compensation, direct or indirect, with respect to any money or other property of such plan, or has any authority or responsibility to do so
- Has any discretionary authority or discretionary responsibility in the administration of the plan.

The named fiduciary should clearly understand the adviser’s role and fiduciary status under ERISA. For example, an adviser who recommends a service provider to provide plan recordkeeping services would be acting in relation to “the administration of [the] plan.” But the adviser would likely not be viewed as acting as a fiduciary because the adviser does not have “discretion” (i.e., final authority) to select the service provider. An adviser who recommends investments, however, would be a fiduciary if they are deemed to provide “investment advice for a fee or other compensation.”

Although a 3(21) investment adviser is a fiduciary, the named fiduciary is not relieved of liability and is ultimately responsible for and makes the decisions. A blind reliance on the investment adviser won’t fend off potential liability.

Remember, the committee or fiduciary is responsible for the prudent process that goes into making decisions though not necessarily the outcome of the decision. For example, if an investment experiences a substantial decline in value, it’s not obvious that a fiduciary breach has occurred. The fiduciary would face mitigated risk if a prudent process went into the selection and monitoring of the investment option and the investment option was a prudent investment, as determined by a knowledgeable expert, at the time of the decision.

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21 See ERISA section 3(21)(A).
ERISA 404(c) protection

A common risk mitigation method for defined contribution plans is ERISA 404(c) protection, which provides relief to the plan fiduciary for the liability of losses when participants select their own investment within the plan. Most defined contribution plans are designed to allow participants to direct the investments of their accounts, but this is not a statutory or regulatory requirement. Participant-directed plans have a wide variety of investment structures. Thus, plans with participant-directed investment are often structured to be compliant with ERISA 404(c). Plan fiduciaries would not be held responsible for poor results due to investment decisions made by participants to the extent that a participant exercises investment control over his or her account within a plan that satisfies all the criteria of ERISA 404(c).

ERISA 404(c) will not protect an investment fiduciary, however, if there are problems due to the investment options available under the plan. For example, investment options that are too expensive, and options with consistently bad returns are harms not caused by participants’ decisions, but instead are due to a fiduciary’s imprudence in selecting and/or monitoring the investments. Thus, ERISA 404(c) does not provide shelter for the selection of the investment options available under the plan; such selection and monitoring must be consistent with the fiduciary rules of ERISA.

Offer a broad range of diversified investment options — participants must be able to choose from at least three diversified investment alternatives, each of which offers significantly different risk and return characteristics.

 Allow participants to transfer assets among the investment options offered — participants must be able to transfer between investments at least quarterly or within a timeframe deemed appropriate based on the market volatility of the investment options offered.

Provide participants with sufficient information to make informed investment decisions about investment alternatives available under the plan, including but not limited to a description of the plan’s investment option and expenses associated with the investment options and any fees that will be directly charged against participant accounts.

Make additional information available to participants upon request, including but not limited to annual operating expenses of each investment, past and current investment performance, and a list of securities and their value held by each investment option.

404(c) protection can shield fiduciaries from the responsibilities of investment losses in participant-directed plans.
QDIA

Another type of relief that a plan fiduciary may want to consider is the qualified default investment alternative (QDIA). In situations such as automatic enrollment or when an investment option is removed, participants often do not provide investment direction and are usually defaulted into an investment option at the direction of the plan fiduciary.

Historically, fiduciaries or committees have chosen to default participants into conservative investment options, such as money market funds, to prevent losses and avoid litigation. However, the most conservative investment option may not be the most appropriate for an individual who is saving for retirement given their goals and risk tolerance. A QDIA provides protection to the plan fiduciaries from liability due to participants’ investment losses, if the requirements are met. Participant notices with the requisite information must be provided to participants initially and annually. The committee is responsible for the selection of the QDIA, and the QDIA must meet certain requirements. See ERISA 404(c)(5).
A participant whose plan account balance is invested in a QDIA must have the opportunity to direct the investment of their account balance but does not do so.

The participant must receive notice that the retirement funds of their account will be invested in the QDIA at least 30 days before the first investment in the QDIA and annually thereafter. The annual notice must be provided at least 30 days in advance of each plan year.

Notices must include:

- A description of circumstances in which the participant’s account balance will be invested in the QDIA and the participant’s right to direct the investment of their plan account balance to other plan options
- A description of the QDIA (including investment objective, risk and return characteristics, and fees and expenses)

- An explanation of where information about other plan investment options can be found

A participant whose retirement funds are invested in a QDIA by default must be able to transfer from the QDIA at least as often as from other plan investment options and at least quarterly.

During the first 90 days after a participant’s account is invested in a QDIA, transfers out of the QDIA cannot be subject to any restriction, fee or expense, unless the fee and expense is charged on an ongoing basis for the operation of the investment (i.e., 12b-1 fees) and are not imposed based on the participant’s decision to transfer out of the QDIA.

The plan must offer a “broad range” of investment alternatives.

If a participant gives investment instructions, the participant’s instructions must be implemented, and the protection provided by the QDIA regulation ends. After that, the plan fiduciary is protected from liability so long as the conditions of the ERISA 404(c) regulations are met in connection with the participant’s investment instructions.

The regulations provide that the following types of investment options may be certified as QDIA:

- A “life-cycle” or “targeted-retirement-date” model
- A “balanced” model
- An investment management service, such as a “managed account”
Mapping

“Mapping” occurs when a fiduciary directs the asset allocation from one or more investment option to another. A common example of mapping is when an investment option is eliminated, either singly or in connection with a change in the plan’s overall investment lineup. In this instance, retirement funds in participants’ accounts are transferred or “mapped” to a replacement investment option that is comparable to the eliminated option. Common scenarios where a plan fiduciary may consider “mapping” are the following:

- A change in service providers necessitates the elimination of some of all of the plan’s investment lineup.
- After a due diligence review one or more investment options in the plan’s investment lineup are replaced.
- Two or more participant-directed plans with different investment lineups merge.

ERISA 404(c) protection can be extended when the replacement investment has “reasonably similar” risk and return characteristics and certain conditions are met:

1. The transactions must involve a reallocation of a participant’s retirement funds from an existing plan investment option that is being eliminated to another plan investment option.
2. The risk and return characteristics of the replacement investment option must be “reasonably similar” to the risk and return characteristics of the existing investment option that is being eliminated.
3. The affected participants must receive at least 30 days (and no more than 60 days) advanced notice of the mapping transaction and have the opportunity to give an affirmative instruction contrary to the proposed change before the effective date of the mapping transaction. The notice must include information comparing the existing investment option and replacement investment option and an explanation that the participant’s retirement funds will be invested in the replacement option unless the participant provides instruction otherwise.
4. The participant must have already affirmatively elected the existing investment option under conditions that otherwise met all the requirements of the ERISA 404(c) regulations. Although Congress indicated that the DOL should issue regulations to clarify the conditions for relief under ERISA 404(c)(4) the DOL has not yet done so.
Self-directed brokerage account
Some plans are designed to allow participants the opportunity to invest their accounts through a self-directed brokerage window. A self-directed brokerage account gives participants the opportunity to select from a broad spectrum of investments that are in addition to the more common investment options of the plan. The fiduciary is responsible for determining the prudence of offering the brokerage window within the retirement plan. For example, if the workforce does not have strong investment knowledge it may not be prudent for the fiduciary or committee to offer a brokerage window and allow participants to select from the myriad options available. However, the choices under the brokerage window are not subject to the same fiduciary review as the investment options under the plan. Thus, many fiduciaries or committees only monitor fees and the system performance of the brokerage window, leaving other tasks to plan participants who utilize the brokerage window.

Employer stock/company stock
Some retirement plans invest in the stock of the employer or have employer stock (also known as company stock) as an option for plan participants. Company stock is treated differently from other investments, being unique in almost all respects from other investment options. From a governance and risk management perspective, it’s important that fiduciaries understand the uniqueness of company stock.

When company stock is added as a plan investment option, the first two questions to ask are:
- Who makes the decision to have company stock available as an investment option?
- And, in what capacity is that decision being made?

There is some debate over whether the decision to include company stock is a “settlor” or a “fiduciary” action. Many plan sponsors take the position that the decision to have company stock in the plan is a settlor decision and not subject to fiduciary standards under ERISA. ERISA has special rules and diversification exceptions for company stock, in recognition of the fact that some options by design require investment in company stock (such as a stock bonus or an employee stock ownership plan (ESOP)). Given the unique status and requirement for these plans to invest in company stock, many plans regard company stock investments as a design or settlor function and not a fiduciary decision. Plan document language that directs company stock investments remains helpful in the positioning of company stock as a settlor decision.
If the inclusion of stock is a fiduciary decision, the committee is responsible for determining that employer stock is a prudent investment. In the past, retirement plans with employer stock could rely on the Moench presumption of prudence. However, the Moench presumption was overturned in the Supreme Court decisions in regard to Fifth Third Bancorp v. Dudenhoeffer in 2014. Initially, some thought that the overturning of the Moench presumption of prudence would be a negative for plan sponsors and fiduciaries with employer stock, but under the Dudenhoeffer standard plaintiffs must show that the proposed alternative would not have done more harm than good, which has proven to be as challenging (if not more so) for plaintiffs than the Moench presumption of prudence.

Plan sponsors can structure company stock investments in different ways within a plan. The most common examples are either as an investment option available within the retirement plan or as employer contributions that may be automatically invested in stock with some rights to diversify at certain times.

Whatever the design, proper governance is extremely important to mitigate risk when using company stock as a plan investment option.

**Plan design features related to company stock**

If the availability of company stock is stated as a design feature of the plan, then any limitations deemed appropriate by the plan sponsor on stock investments should be set forth in the plan. Decisions that will need to be made include:

- Can all money sources — elective deferral contributions, matching contributions, etc. — be invested in company stock? Or, are the sources available for stock investment limited?
- Will there be percentage limits on how much a plan participant can invest in company stock?
- How often are trades in and out of stock allowed?

A plan design decision to allow company stock as an investment option will affect the governance responsibilities of the retirement plan committee or other named fiduciary. The committee is required to follow the terms of the plan, insofar as they are consistent with ERISA and the Dudenhoeffer standards.

Because of the unique nature of company stock, plan fiduciaries typically set forth standards for the management of company stock in the investment policy statement. All governance documentation and processes relating to company stock should be set up consistently — meaning that the plan document, investment policy statement, summary plan description and other documents should support the defined role of company stock under the plan.

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Company stock not treated as a design feature
If the availability of a company stock fund is not mandated by plan terms but instead is a function of committee discretion, the committee’s governance documents and processes must be structured to reflect that. For example, the committee would probably conclude that the investment policy statement should measure the performance of the company stock against an appropriate benchmark and otherwise describe the process the committee will follow in monitoring the stock.

Voting company stock
One of the requirements of ERISA 404(c) protection for company stock investments (as well as for tax law compliance purposes in the case of an employee stock ownership plan) is that voting, tender and similar shareholder rights need to be passed through to participants. The pass-through rights should be established as a matter of plan design in the governing plan documents, which should also dictate the voting process to some degree.

Many plans provide “mirror” voting rules in the case of shares that are held in unallocated accounts or shares held in participant accounts for which voting instructions have not been received by participants. With mirror voting, such shares are voted in the same proportion as votes cast by participants. To the extent any discretion is retained by the plan fiduciaries in the implementation of pass-through voting instructions, a voting process should be established in the plan document and investment policy statement.

Securities registration and prospectus considerations
If company stock is available as an investment under the plan, the plan sponsor will need to consider the implications federal and state securities law may have on that particular plan structure. Allowing employee money sources — elective deferral contributions, rollover, etc. — to be invested in company stock likely will require that interests in the plan be registered under federal securities law (although a more simplified Form S-8 registration may be available). Similarly, a prospectus may be required for the plan. Limiting company stock investments to employer money sources may avoid registration and prospectus requirements and their related costs.

NYSE and NASDAQ considerations
For a company whose shares are traded on the NYSE or NASDAQ, when implementing a company stock option for the plan or making material revisions to the company stock feature, the plan sponsor may need to consider whether action is required by its compensation committee in accordance with stock exchange rules.
Fees
The fiduciary or committee has the responsibility to ensure that the fees and expenses being paid by the plan are reasonable for the services being provided. If a fiduciary fails in this respect, a prohibited transaction most likely occurs, since most service providers rely on the prohibited transaction exemption in ERISA 408(b)(2). If a fiduciary fails, it increases litigation risk.

The fiduciary should identify all the overall fees being paid for the retirement plan with a breakdown of their components, such as administrative/recordkeeping services, investment management, and any financial professional services. Next, the committee should understand the breadth, depth and quality of the services being received for the fees. For example, fees can vary greatly due to unique plan characteristics, plan/investment design and range, quantity and quality of service negotiated between the employer (and retirement plan committee) and retirement service providers. Finally, a comparison of the costs versus services should be completed.

Not all services can be paid for with plan assets. Only plan expenses that are relevant to the operation and maintenance of the plan can be paid by the retirement plan. Expenses for settlor functions (employer decisions and actions) are not essential to the operation of the plan and should not be paid for with assets from the plan. It’s the fiduciary's responsibility to determine which expenses can be paid for with plan assets and which ones cannot.

Determining the reasonableness of fees and expenses of the plan
Understanding and maintaining reasonable fees and expenses is part of the fiduciary responsibility of any fiduciary that is tasked with engaging service providers or selecting investment options. Counterintuitively, ERISA starts by saying that a fiduciary may not hire any plan service provider for compensation, but ERISA then provides an exemption from this broad prohibition for service contracts or arrangements that are “reasonable” and necessary for the establishment or operation of the plan and for which the service provider receives no more than reasonable compensation. As part of the 408(b)(2) exemption, the service provider discloses information — the 408(b)(2) disclosure notice — about services and their fees to the plan fiduciaries. This notice is a useful resource for a retirement plan committee or fiduciaries, assisting them with their fiduciary duty to monitor fees and services for reasonableness.

25 See ERISA Section 408(b)(2).
Therefore, it’s the responsibility of the plan fiduciary to make sure that the service provider’s agreement and compensation are “reasonable.” “Reasonableness” does not necessarily equate to the lowest fees and should be determined in relation to the services received considering the quality of those services and the benefit to participants and beneficiaries as well as other factors. In general, whether compensation is reasonable depends on the fair market value of the goods or services provided to the plan compared to the cost of similar service goods or services available in the same geographic location.

**Other factors to consider in addition to plan fees:**
- Objectives of the plan
- Services received and quality of those services
- Reputation of the service provider and their commitment to the retirement industry
- Benefits of the services to plan participants

It’s important to evaluate the total amount that’s paid to all service providers for the plan from all sources — including direct and indirect fees. The appropriate fiduciaries should document the review process and maintain it in a due diligence file.

**Thus, it’s important that the fiduciary understands:**
- Who is receiving the fees and expenses
- What services are being provided for such compensation
- How the plan fees are being paid

Part of satisfying the 408(b)(2) prohibited transaction exemption is the requirement for service providers to disclose to plan fiduciaries specific information, including compensation earned by the service provider and its affiliates with respect to services provided to the plan. If these requirements are not met or compensation is not “reasonable,” contracting for plan services and providing those services are nonexempt prohibited transactions, which can result in significant liability to the plan fiduciary and the service provider.

The Employee Retirement Income Security Act of 1974 (ERISA) requires plan fiduciaries to act solely in the interests of, and for the exclusive benefit of, participants and beneficiaries. As part of that obligation, plan fiduciaries are responsible for ensuring the costs of operating the plan are reasonable compared to the value being received.

There is also a fiduciary responsibility around the way fees are collected from the retirement plan. Some of the methods that can be used to pay service providers are revenue sharing, billed fees, deducted fees and asset-based fees. It’s not uncommon for a retirement plan committee to use multiple methods for paying fees.
The DOL offers two primary principles to help guide retirement plan committees as they make fee allocation decisions:

- First, consider the interests of different classes of participants.
- Second, determine how the allocation method may affect each class.

While there’s no one right answer, a fiduciary should have a repeatable, documented process for evaluating the effect of fees on participants and a rational basis for the chosen approach.

Consider these steps:

- Gather and evaluate facts (including participant needs)
- Assess available fee payment methods
- Determine fees collected and document the process
- Provide clear simple participant communication
- Monitor

Fiduciaries can create evidence of a prudent process by documenting their consideration of fees and expenses. Thus, fiduciaries should document and retain the processes followed as well as the factors and alternatives considered. Compensation paid to service providers and compensation received by service providers from third-party sources (e.g., revenue sharing payments relating to mutual funds) should be included in the analysis and reviewed on an ongoing basis. If the plan sponsor has divided fiduciary roles into multiple committees, the committees will be jointly responsible for determining the reasonableness of compensation.

Keep in mind that even if the fiduciary determines that compensation paid to a service provider is reasonable, the retention and monitoring of the service provider must still be consistent with ERISA's standards of prudence and acting in the best interest of participants and beneficiaries. Documentation is the best defense in case of litigation. A fee policy statement is a useful tool for analyzing fees and expenses for reasonableness as well as good documentation of the review in case of litigation. Fee policy statements typically include a rational basis for the payment methods that were selected.

Plan fiduciaries should fulfill their responsibilities prudently — and have something to show for it. A fee policy statement is a valuable tool to help do just that. It reflects the process for evaluating fees and expenses and shows that the plan fiduciary understands their responsibilities.26

26 Steven Saxon, Groom Law Group.
Section 5

Communication and education

Fiduciaries are required to provide various disclosures and notices to plan participants and beneficiaries in compliance with laws and regulations.

In addition, because effective employee education can be critical to the success of a retirement plan, many employers uphold a responsibility to educate participants to help them prepare for retirement. Greater knowledge of the retirement benefits increases awareness and appreciation of what is being offered to the participants and beneficiaries. This should drive better decision-making and improved retirement outcomes for participants. Notices are one of the ways that an employer can provide information to participants.
Participant notices

Participants and beneficiaries in qualified retirement plans must receive information about the plan on a regular basis. Both ERISA and the federal tax code require certain disclosures. Examples (not all-inclusive):

- **Notices specific to the plan’s design**: safe harbor, automatic contribution arrangement, eligible automatic contribution arrangement
- **Notices required for qualified plans**: summary plan description (SPD), summary material modifications (SMM), summary annual report (SAR)
- **Notices to inform participants on investments and fees**: qualified default investment alternative, 404(a) participant disclosure for fee disclosure
- **Notices to communicate a change to the plan**: Sarbanes-Oxley (SOX) blackout notice, notice of investment change, notice of fee change, safe harbor discontinuance, SPD, SMM

Plan fiduciaries have the responsibility to understand the timing requirements and recipients of each notice. Plan fiduciaries should keep detailed records of required communications including copies of the:

| Materials sent | A listing of the participants and beneficiaries included in the communication, including the method of delivery (i.e., electronic, paper) and the address utilized (i.e., mailing address or email address) | The date communications were sent |
Participant education

Retirement plans can be difficult for participants to understand. There are multiple stages throughout a participant’s life when they may seek out or benefit from education:

To build understanding and appreciation of the benefits provided, plan sponsors may consider providing education on how to:

- Save within the plan
- Establish secure credentials to protect their retirement accounts
- Navigate the investment options offered
- Designate beneficiaries
- Consolidate retirement accounts via rollovers to decrease risk of losing track of benefits

To encourage increased savings rates, plan sponsors may consider education on:

- Retirement savings needs
- Maximizing employer contributions
- Retirement income projections and the various assumptions used in the calculations
- Plan design changes
- Types of fees (e.g., investment management, administrative/recordkeeping, transactional)
- Understanding the resources made available by the plan sponsor

To help terminated or retired participants understand ways to decrease the chance they’ll outlive their savings, plan sponsors may consider educating participants on distribution options available in addition to a cash distribution. Options may include (varies by plan):

- Roll assets to an individual retirement account (IRA) or another qualified retirement plan
- Keep assets in the plan until retirement
- Annuitize some or all the assets to decrease the risk of spending the assets too quickly
- Cash distributions
To capture education and communication efforts, some employers have an education plan or a formal education policy statement that outlines the objectives for providing education and information to participants with savings, investment and retirement decisions. ERISA does not require an education plan or policy statement, but it can be a tool to help carry out the overarching goals for the retirement plan.

When drafting an initial education plan or policy statement, plan fiduciaries should consider their goals, objectives and any unique educational needs that may exist for their participant and beneficiary populations. This may result in plan design changes such as automatic enrollment, automatic increase, and stretched match formulas to combat low savings rates and participant inertia. Plan design changes in conjunction with a well-designed education plan can help plan sponsors improve plan results such as higher levels of participation, greater savings rates and better participant outcomes. To evaluate the effectiveness, plan sponsors may consider setting target measures and periodically revisiting the results.
Risk mitigation strategies

ERISA establishes the standards of conduct that apply to plan fiduciaries.

If an act (a decision, an action taken, an action omitted, etc.) is “fiduciary” under ERISA, then that act must be undertaken solely with the interest of the participants and beneficiaries in mind, prudently and in accordance with the terms of the plan document and ERISA. Given that the consequences of a fiduciary breach can be significant (especially if bad behavior is involved on the part of the fiduciary) risk mitigation techniques are essential to maintaining a successful retirement plan.
Risk mitigation strategies reduce the likelihood of a fiduciary breach or operational error and assist fiduciaries in their compliance with the standards of conduct for ERISA fiduciaries.

There are eight common strategies for mitigating risk.

1. Establish a retirement plan committee
2. Maintain a prudent process in the selection of investments and document the process
3. Create and follow the investment policy statement
4. ERISA 404(c) protection
5. QDIA protection
6. Understand responsibilities as well as governing documents
7. Maintain a plan design consistent with good governance
8. Risk shifting methods
   a. Fidelity bond
   b. Fiduciary liability insurance
   c. Indemnification of plan fiduciaries
   d. Cyber security insurance

Learn more about risk mitigation strategies you can use to reduce the likelihood of a fiduciary breach.
1 Establish a retirement plan committee

A retirement plan committee reduces risk by formalizing and centralizing decisions around the retirement plan. A successful retirement plan committee will typically have meeting minutes and committee charters that provide documentation of a prudent process around fiduciary responsibilities and actions. If a retirement plan committee has a diversity of skillsets that are relevant to effectively carrying out the responsibilities of running a retirement plan, it may make better decisions. Members selected to be on the committee must be capable of performing up to the standards of conduct and must understand the negative consequences from failing to uphold fiduciary duties. Determining who serves on the committee can be dependent on the structure and culture of the organization. Finance, human resources and legal are possible areas of the organization to look for the appropriate skillsets for the retirement plan committee.

For more information, go to the retirement plan committee section.

2 Maintain a prudent process for selecting investments and document the process

It’s critical that fiduciaries maintain their responsibility to follow a prudent process in selecting the investment options that are available to participants of a defined contribution plan. An investment policy statement establishes a framework for making such investment decisions as well as for managing fiduciary risk. For retirement plans with an investment committee, the committee charter statement, meeting minutes/notes, and other materials will provide documentation of the prudent process for selecting and monitoring investment options. These documents, along with the investment policy statement, would be a key focus if litigation were to occur. Fees and expenses related to investment options and services being provided should also be reviewed for reasonableness. The fiduciary or investment committee should ensure that an adequate number of investment options are available.

For more information, go to the prudent process section.
Create and follow the investment policy statement

Following a comprehensive investment policy statement significantly reduces risk and is also a useful tool for plan fiduciaries. For plans with an investment policy statement, it is essential that fiduciaries and investment committees follow this document, since a failure to do so could be viewed as a fiduciary breach. Thus, an investment policy statement significantly reduces litigation risk, although ERISA does not require that plan fiduciaries maintain one.

The structure of an investment policy statement will differ depending upon whether the plan fiduciary is selecting funds for a participant-directed plan, managing investment options under a profit-sharing plan with no participant-directed investments, or managing investment options under a defined benefit plan. An investment policy statement should address the prudent process for the selection and monitoring of investments.

For more information, go to the investment policy statement section.

ERISA 404(c) protection

ERISA 404(c) protection provides relief to plan fiduciaries of defined contribution plans that allow participants to select their own investments within the plan. For plans that are compliant with ERISA 404(c), fiduciaries would not be held responsible for poor results due to investment decisions made by participants. Note: Fiduciaries remain responsible for the selection and monitoring of investment options available under the plan.

For more information, go to the ERISA 404(c) protection section.
QDIA protection

Plan fiduciaries may also want to consider the risk mitigation strategy of the qualified default investment alternative (QDIA), which applies in situations where participants do not provide investment direction (such as automatic enrollment or when an investment option is removed). A QDIA protects plan fiduciaries from liability due to participants’ investment losses if the requirements are met (such as a notice requirement and other requirements under 404(c)(5)). In addition, the committee maintains fiduciary responsibility for the selection of the QDIA.

For more information, go to the QDIA section.

Understand responsibilities and use governing documents

A retirement plan should have processes and procedures to reduce the likelihood that the operations of the plan stray off course. The objective is to keep the plan within the guardrails of regulations as well as the provisions of the plan document. It’s critical that individuals handling the retirement plan know all the governing documents that have been established and that all terms of the governing documents are being followed. When a retirement plan does not operate according to its governing documents, it’s commonly viewed as an operational error or fiduciary breach. Examples of key governing documents include:

- **Plan document**: The plan document must expressly provide whether named fiduciaries may allocate duties among themselves or appoint another fiduciary (who is not a named fiduciary) to carry out responsibilities (other than trustee responsibilities) to the retirement plan.

- **Trust instrument**: Plan assets must be held in trust by one or more trustees unless assets are held by an annuity contract, custodial account, or a contract established under sections 403(b) and 404(c)(5). For every trust, there must be a trust instrument that describes how it is to be operated. The trust instrument may either be a separate document from the retirement plan or part of it. Either way, the DOL considers the trust instrument to be a part of the governing documents of the plan.
The trustee must be identified in the trust instrument or appointed by a named fiduciary, which is usually the committee. It may be more practical not to specifically name the trustee in the trust instrument, but rather provide for the trustee’s appointment by the named fiduciary (like not specifically using names for the named fiduciary in the plan document). This will permit the named fiduciary to identify the trustee outside of the trust instrument, which means the trust instrument will not need to be amended solely as the result of the appointment of a new trustee.

**Charter statements:** Good governance would dictate that one or more charters be established to define the responsibilities of the fiduciary committees (and any settlor committees). Elements may include:

- An introduction, including a description of where the committee fits in the governance structure and with respect to other fiduciaries or fiduciary committees

- The scope of the appointment, e.g., what plans the charter covers

- The membership of the committee, including how many committee members are required; whether there are any qualification requirements; how members are appointed; removal or resignation procedures; automatic triggers that cause an individual to no longer be a member (e.g., termination of employment); and extended absences

- The committee secretary, including how the secretary is to be appointed and what his or her responsibilities will be

- Indemnification, including terms and conditions of the organization’s indemnification policy applicable to individual named fiduciaries or committee members — if such provisions are not in the plan document or separate indemnification policies or agreements

- Any conflicts of interest, including procedures for reporting potential conflicts of interest to the organization and other committee members

- Duties that have been specifically allocated to the committee

For more information, go to the [Understanding responsibilities](#) section.
Have a plan design that supports good governance

A retirement plan can be designed to promote good governance. Too much complexity and too many manual processes increase the probability of error. It’s important for organizations to consider the goals and objectives of the retirement program in conjunction with the capabilities of the organization and service providers to carry out the goals and objectives. The plan sponsor and/or settlor committee may want to focus on keeping the plan design from getting complex when strategizing how to recruit and retain the diverse groups of employees within the organization.

In addition to the organization’s administrative considerations, plan design can be used to promote desired employee behavior, such as saving for retirement. The following are examples of key plan design components that can help mitigate administrative complexity and potentially promote desired employee behaviors (depending on the organization’s goals and objectives).

✔ Automated features: Automatic enrollment and annual escalation provide a path for participants to save for retirement without having to make decisions or proactively take action. It provides an avenue for helping the participant engage with the plan without forcing the participant to decide when to start deferring into the plan, what rate to contribute, what investment lineup to use, etc. It also provides a need to create processes to support the requirements of automated features.

✔ Entry requirements: While diverse options are available, to avoid unwanted complexity, it’s critical to understand what the organization can handle effectively when defining entry/eligibility requirements for the plan.

For example, if hours are used, can they effectively be tracked? If different groups have distinct entry requirements, can the organization handle the differences? Balancing complexity with feasibility can be a key aspect to minimizing errors in determining when an employee is eligible to enter the plan.

✔ Loans: Limiting participants’ access to plan assets can help maximize participants’ retirement outcomes and help minimize the administrative hassles of managing the retirement plan at the same time. Limiting to what degree, if at all, a participant has access to their money through a loan is one approach.
**Forms of benefit:** Diversification is heavily discussed during the accumulation phase for a plan participant and can be a key to a successful decumulation strategy as well. Giving options of guaranteed income streams along with lump sum options can provide one avenue to diversifying decumulation.

While plan designs can be very complex, it may be advantageous to investigate ways to simplify the design to leverage the opportunity to use a plan document that has been approved by the IRS. One method available to plan sponsors is to use an IRS pre-approved document, such as a prototype or volume submitter. Using this type of document allows the plan sponsor to use wording that’s already been reviewed and approved by the IRS.

**Risk shifting methods**

Risk shifting methods are available for protecting participants, fiduciaries and the assets of the retirement plan. ERISA requires that retirement plans maintain a fidelity bond. Other risk shifting methods (such as fiduciary liability insurance, indemnification of plan fiduciaries and cyber security insurance) are voluntary.

**Fidelity bond** Generally, ERISA requires every fiduciary and individual who handles plan assets to be bonded unless an exemption applies. The fidelity bond protects a plan against losses due to fraud or dishonesty on the part of those handling plan assets. Individuals who are required to be bonded generally include the plan administrator and officers and employees of the plan sponsor whose duties or activities regarding the plan assets create a risk of loss from fraud or dishonesty. Individuals may be required to be bonded even if they have no discretionary authority over plan assets, but there is the potential for theft because they handle plan assets.

Generally, each person must be bonded in an amount equal to at least 10 percent of the plan assets he or she handled in the preceding year. The bond amount cannot be less than $1,000, and the DOL cannot require an individual to be bonded for more than $500,000 (a maximum of $1,000,000 for plans that hold company stock).

The responsibility for ensuring that those who handle plan assets are bonded may fall upon multiple individuals, including the plan sponsor and plan fiduciaries. When a named fiduciary hires fiduciary and non-fiduciary service providers, the named fiduciary should take steps to ensure those service providers are bonded to the extent required by ERISA.
**Fiduciary liability insurance** Generally, fiduciary liability insurance insures the plan, its fiduciaries and/or the plan sponsor against losses caused by breaches of fiduciary duty. A fiduciary liability insurance policy is usually obtained from a properly qualified property and casualty insurance broker or agent.

The fiduciary liability policy may be a stand-alone policy or rider on an existing policy. It's important for the plan sponsor and all plan fiduciaries to understand the full scope of the coverage. Fiduciary liability insurance will have certain exclusions and coverage will not apply for all claims in all situations.

It's also important to understand the following under the fiduciary liability policy:
- What constitutes a “claim”
- When the claim must be reported to the insurance carrier
- What time period the policy covers

Time limits for reporting a claim are dictated by the terms of the policy. Failure to timely report a claim could bar any coverage for the claim.

Periodically throughout the policy term, it's a good practice to ask plan fiduciaries and employees who perform services relating to the plan whether they are aware of any potential claims or circumstances that may implicate coverage under the policy. Responses should be evaluated by a qualified individual to determine whether the matter needs to be reported to the insurer. This qualified individual could be the organization's legal counsel, the officer or employee responsible for overseeing the organization's insurance program, or the agent or broker that placed the fiduciary liability insurance policy.

Generally, liability insurance policies for directors and officers exclude coverage for persons serving as ERISA fiduciaries of any plan established or maintained for the benefit of the employees, but a fiduciary rider to such policies may be available.
Indemnification of plan fiduciaries  Officers and employees who serve as plan fiduciaries will likely expect an assurance from the organization that they will be indemnified against personal liability. An agreement to indemnify another fiduciary is not a fidelity bond and is not an insurance policy. An organization that provides indemnification to plan fiduciaries agrees to compensate the fiduciary for various losses the fiduciary incurs as a result of service in a fiduciary capacity. An indemnification provision may be contained in the plan document. The plan sponsor may choose indemnification guidelines covering all fiduciaries that are officers or employees, or it may enter into separate indemnification agreements with plan fiduciaries. In any case, the terms of the organization's agreement to indemnify a plan fiduciary should carefully lay out its terms and limitations.

Retirement plan committee members may want to check with the secretary of their corporation to determine whether the organization has adopted a policy relating to indemnification or whether there are any limitations in the organization's governing documents or state law that would prohibit the adoption of such a policy. If state law permits the organization to indemnify only officers and directors, and not employees, then that may affect the appointment of plan fiduciaries.

Cyber security insurance  Management of a retirement plan typically utilizes multiple service providers when operating the retirement plan. Service providers such as plan administrators, auditors, attorneys and consultants may have access to sensitive employee information including Social Security numbers, addresses, dates of birth, bank account information, etc. With the multiple layers of access to sensitive information, cyber security risk can compound.

While cyber security threats cannot be 100% prevented, measures can be taken to mitigate the threat. Stand-alone cyber security insurance policies are available. With cyber security insurance being a relatively new insurance product, it’s critical for the plan sponsor and all plan fiduciaries to understand the following:

• What their current insurance policies cover
• What the cyber security insurance policy will cover
• What gaps still exist and how much exposure remains
Prohibited transaction and other actions to avoid

Most of the material here addresses actions, decisions and considerations of the fiduciary. Nevertheless, there are certain actions that a fiduciary should avoid. When Congress was creating ERISA, it decided that certain types of transactions were too risky and too likely to invite litigation, and consequently, those transactions were entirely prohibited. The main motivation was to prevent bad behavior from fiduciaries and protect the retirement benefits of employees. Prohibited transactions are a fundamental element of ERISA.

There are two broad categories of prohibited transactions.

The first is based on transactions between a plan and a “party in interest.”

A “party in interest” is a class of persons and other entities that have some tie to a plan, such as the employer that sponsors the plan, a service provider to the plan, a plan participant, or a plan fiduciary. Prohibited transactions include the following transactions between a plan and a “party in interest”:

- Sale or exchange, or leasing, of any property between the plan and a party in interest
- Lending of money or other extensions of credit between the plan and a party in interest
- Furnishing of goods, services, or facilities between the plan and a party in interest
- Transfer to, or use by or for the benefit of a party in interest, or any asset of the plan
- Acquisition, on behalf of the plan, of any employer security or employer real property in violation of ERISA

The second category of prohibited transactions deals with the actions of a plan fiduciary and prohibits certain activities. For example, when acting on behalf of a plan, fiduciaries may not deal with plan assets in the fiduciaries’ own interests. The following are examples of prohibited transactions between a plan and fiduciaries:

- Dealing with the assets of the plan in their own interest or for their own accounts
- Acting in their individual accounts, or in any other capacity, acting in any transaction involving the plan on behalf of a party (or represent a party) whose interests are averse to the interests of the plan or the interests of its participants or beneficiaries
- Receiving any consideration for their own account from any party dealing with the plan in connection with a transaction involving the assets of the plan

Note that these categories are very broad. How do transactions ever take place between the plan and anyone? The answer is prohibited transaction exemptions.
Given the substantial limitations that prohibited transactions impose on a retirement plan, there are prohibited transaction exemptions to allow for the party in interest to engage in described transactions when certain conditions are met. ERISA allows for these specific transactions via prohibited transaction exemptions — statutory (part of the law) or class (permitted by the DOL). An example of a prohibited transaction is for loans. Loans are prohibited to a “party in interest”; however, loans can be allowed if the requirements of the prohibited transaction exemption are met, such as being made available to all participants and beneficiaries on a reasonably equivalent basis.

**Other key actions to avoid as a fiduciary include:**

- **Covering for another fiduciary.** This could create co-fiduciary liability. The covering fiduciary would become personally liable up to 100% of the breach. Upon learning of the bad actions, the other fiduciary must take steps to correct the failure or may be forced to become a whistleblower to inform others of the bad behavior.

- **Failure to follow the terms of the governing documents.** The plan is a legal document, and fiduciary responsibility entails managing the plan to the terms of the legal document to the extent it is consistent with ERISA.
Conclusion

Good governance is a continuous process that helps you, the plan sponsor, successfully operate your retirement plan and improves retirement outcomes for plan participants.

When plan sponsors and fiduciaries understand their responsibilities to the plan as well as their personal liabilities if things were to go wrong, they tend to be more successful at establishing and maintaining a retirement plan.

Ongoing governance training is essential for committee members and plan fiduciaries. Presentations and training sessions on good governance as well as updates on legislative or regulatory changes strengthen the operations of the retirement plan committee. Some committees keep a running log of issues to discuss at the next governance training session or committee meeting. Also, documentation of training sessions and other fiduciary development activities provides evidence of a prudent process.

Although the retirement landscape will change, a prudent path typically prevails.

The core principles of governance — process, documentation and meeting fiduciary standards — are well-established, but they’re not static and they continue to evolve. Retirement plan committee members should work to strengthen their knowledge of good governance, the governance processes and structure of their specific retirement plan, and their specific obligations to that plan. It’s important for plan sponsors to be aware of current trends and occurrences in the industry as well as providing tools and resources to help fiduciaries manage their retirement program.
We can help

Principal is committed to helping plan sponsors and participants save enough, protect enough and have enough in retirement. Our team of experts continues to evaluate and interpret new legislation, regulation and industry trends so we can provide the support and solutions you’re looking for.

If you have any questions about your plan or this guide, please contact your Principal representative for questions or additional information.

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