# THE EXCELLENT FIDUCIARY

# Secrets of a Professional Fiduciary

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The challenges of the modern fiduciary are plentiful and complex. Increasingly stringent regulations coupled with convoluted industry norms contribute to a fiduciary role that is hard to define, and even harder to master. Many fiduciary executives and committees experience—at best—feelings of tentativeness regarding their fiduciary duties and success, and—at worst—severe doubt and uncertainty regarding the state of their fiduciary practices. However, those fiduciaries who have a "professional" mindset and are governed by stewardship principles can follow a simplistic formula for minimizing risk, maximizing value for their stakeholders, and meeting (or exceeding) fiduciary industry standards.

Who is the modern fiduciary? There are different groups, or "neighborhoods," that comprise the fiduciary community and contribute to the professional fiduciary's success. This community consists of all of those people and groups who retain fiduciary responsibility under ERISA, UPIA and/or UPMIFA,[1] and include the following:

- Private sector enterprises that sponsor retirement plans;
- Public pensions;
- Non-profit organizations like foundations and endowments;
- Individuals such as directors, financial executives, and human resources managers (referred to separately as a "Primary Fiduciary") who are on the payrolls of the above-listed organizations;
- Vendors that perform fiduciary functions under contract to the above listed organizations and acknowledge their fiduciary status in writing; and
- Vendors that are fiduciaries by virtue of the services they provide but refuse to admit they are fiduciaries.

If managed properly, many of these neighborhoods of fiduciaries may work together harmoniously, resulting in the execution of fiduciary practices that adhere to a certain standard of conduct. This article will address how Primary Fiduciaries may best understand and fulfill their role by heightening their awareness, defining processes, and intelligently leveraging the expertise of the greater fiduciary community.

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## GENERALISTS VS. SPECIALISTS

The fiduciary community is populated by both general practitioners, or Generalists, and Specialists (please see Exhibit A). The important difference to note between Generalists and Specialists regarding the fiduciary role is that Generalists employ the services of Specialists, and not vice versa. In other words, Generalists are responsible for the oversight and effective management of the practices of those Specialists they employ, as dictated by fiduciary duty. A professional fiduciary (defined more in depth later) is quick to identify and understand the roles of all of the players within her fiduciary community, in order to construct the best fiduciary plan for her stakeholders.

*Exhibit A*

| The Fiduciary Community: Specialists vs. Generalists | |
|---|---|
| **Specialists** | **Generalists** |
| Independent administrative fiduciaries<br>Vendors of investment services<br>Vendors of recordkeeping services | Directors, executives, and managers of endowments and foundations, ERISA retirement plans, and public pensions |

General practitioners include directors, executives, and managers of endowments and foundations, ERISA retirement plans, and public pensions. Independent administrative fiduciaries are specialists in managing all aspects of fiduciary duty including governance, administration, investments, and controls. They do not offer investment or ministerial services such as recordkeeping due to the conflict of interest it would pose. Vendors of investment services are examples of specialists, albeit in a limited aspect of fiduciary duty. The best among them acknowledge their fiduciary duty in writing. Vendors of recordkeeping services are specialists that provide ministerial services, some of which might be fiduciary in nature. Rarely, however, do recordkeeping and third party administrators that sell such ministerial services acknowledge a fiduciary responsibility in writing.

By understanding the distinct role specialists play in each unique fiduciary situation, Generalists (or Primary Fiduciaries) may better equip themselves with a risk-averse fiduciary approach and plan of action that will fulfill their legal obligations and maximize results for their key constituents.

## THE PROFESSIONAL FIDUCIARY'S ROAD TO SUCCESS

How does a Primary Fiduciary qualify as a professional fiduciary? Primary Fiduciaries who claim this title believe in a key principle related to their fiduciary role—they believe that stewardship of other people's money is both a calling and a duty that demands the attitude of a professional. This professionalism is evidenced by a pursuit of knowledge, adherence to a defined standard of conduct, hunger for experience, and distinct care in the decision-making process.

Professional fiduciaries, then, possess the following distinguishable traits:

- knowledge of the full range of their legal duty;
- advanced technical skills in governance, administration, investments, and controls;
- devotion to independence;
- commitment to loyalty; and
- dedication to the exclusive purpose for their existence (the prudent management of others' monetary assets).

These five traits, in total, assure that professional fiduciaries are committed to excellence and pursue an ethical process in the management of their stakeholders' assets.

As discussed earlier, we will focus our attention on the formula for success for Primary Fiduciaries who align with the characteristics we listed above—"professional fiduciaries." The professional fiduciary's success formula is comprised of five key elements:

1. Training
2. Procedures
3. Oversight
4. Procurement
5. Assessment

Next, we will examine what each of these steps entails, as well as practical ways to implement them for professional fiduciaries seeking a failsafe approach to their stewardship role.

**Training** for the professional fiduciary entails mastery of the required skill sets, clarity of the legal environment, and precision in understanding duties. Yet the state of knowledge about how to perform this job, according to a recent report by the Department of Labor (DOL), is at an alarmingly low point.

While researching the matter of competency among retirement plan fiduciaries, the DOL interviewed a wide array of individuals. They included representatives of the major organizations of professionals who advise fiduciaries on compliance issues (independent Administrative Fiduciaries, the American Bar Association, the American Institute of Certified Public Accountants, and the American Society of Pension Actuaries); attorneys for small and large plans; attorneys for participants; a representative of the largest insurer of ERISA fiduciaries; representatives of the primary professional organizations representing large and small plan sponsors; and representatives of the IRS. There were, not surprisingly, important differences in perspectives, but there was also widespread agreement that education can help fiduciaries perform better.

Most Primary Fiduciaries have honest intentions and want to perform well. This may not be surprising but it certainly supports the idea that education has an important role to play in fiduciary compliance: a pure heart and an educated head are the prerequisites for a high level of fiduciary performance.

With the collapse in value of retirement savings plans in recent years, which has focused attention on and awareness of fiduciary responsibility, we may be in a teachable moment. There is little doubt left that formal training for senior executives and fiduciary committee members can radically improve retirement plan outcomes.

**Procedures** include defining processes within the fiduciary's organization that support legal and ethical mandates. While retirement plan sponsors are making progress in their awareness of ERISA's requirement that they follow a prudent process, a lot of confusion persists about how such a process looks. To be sure, a prudent process is manifested in procedures. ERISA does not, however, define the procedures. The reality that these procedures have emerged from harsh trial and error confounds many executives. The situation is not, however, without precedent. Global governments faced the same kind of challenge after World War II. Devastated countries needed a way to reconstruct their smashed economies by gaining access to markets where money to buy products and services had survived the war. Standards for manufactured products and consumer services emerged. Without such standards, it is hard to imagine how today's global network of information and product flow could exist. In like manner, procedures are needed in the form of standards in order to ensure

that Primary Fiduciaries satisfy ERISA's prudent process rule. (The Investment Fiduciary Leadership Council is a not-for-profit organization that is building fiduciary standards for retirement plan sponsors. For more information on how to implement standards and related processes, visit www.iflcouncil.org .)

**Oversight** requires Primary Fiduciaries to understand, reason, and enforce the boundaries inside which other fiduciaries and vendors must reside. ERISA defines clear boundaries for the management of a retirement plan's decision-making process. The chain of responsibility begins with the Primary Fiduciaries. They, in turn, may delegate with close supervision certain decisions to professional independent administrators, money managers, trustees, and investment advisors, which are addressed by several names (e.g., financial consultants, securities brokers, insurance agents, and financial planners). But even when decisions are delegated to one or more professionals, a Primary Fiduciary can never escape the primary responsibility for supervising the decision-making process. As referenced earlier, Primary Fiduciaries (Generalists) are legally responsible for overseeing and effectively managing the entire fiduciary process, including verifying the prudence of their Specialists' practices. Therefore, maintaining a checklist of items that regularly require professional fiduciaries' oversight is a necessity of the prudent fiduciary process.

**Procurement** involves the expertise necessary to manage a complex supply chain, including the ability to understand vendors' cost structures. Managing the pension plan supply chain is the most fundamental duty of a Primary Fiduciary. ERISA expressly requires that the procurement of services must be funded from a retirement plan's assets in order to be conducted prudently. Prudence focuses on the *process* for making decisions. Wisdom dictates, therefore, that the process be constructed on a sound platform of knowledge about how the services to be acquired are priced, delivered, and monitored ongoing. The ability of most Primary Fiduciaries to perform well at procurement was the subject of a recent industry-wide study. The result of the study, which was performed by the Advisory Council of the DOL, was published in the *Federal Register*. A key finding is stunning. It reads, "Vendors have a strong incentive to use their information advantage to distort market outcomes in their own favor. Current ERISA rules hold plan sponsors rather than vendors accountable for evaluating the cost and quality of plan services." In light of the findings of the study, Primary Fiduciaries should seek unbiased help when selecting vendors and evaluating them following their hiring.

**Assessment**, the final element, requires that the fiduciary seek isolation from conflicting roles. Many Primary Fiduciaries find out too late about the importance of identifying and reducing the conflicts of interest that have become an inherent part of the retirement plan landscape. In order to compete in the commodity-like market of retirement plan services, many vendors of pension consulting, investment advice, recordkeeping, and trustee services have combined these offerings in order to drive down their costs. This approach, also called the "multiple hat" business model, camouflages the very conflicts of interest that are required to be examined and controlled under ERISA.

In a landmark decision, the U.S. Supreme Court raised a red flag that professional fiduciaries do not ignore. The high court's decision in the case of *Metropolitan Life Insurance Company et. al. v. Glenn* will have monumental repercussions throughout the ERISA community for years to come. The decision vanquishes the

notion that mere disclosure of conflicts of interests will save a Primary Fiduciary from substantial liability. How far down the food chain its effect will travel is not known, but the following is certain:

- Any retirement plan official that engages vendors to provide "multiple services," that is services other than a single category of deliverables, places his or her plan and his or her person at risk.
- Plan officials cannot waive conflicts of interest.
- The way to avoid conflicts of interest liability is to require service providers to do only one thing.

ERISA echoes the Supreme Court's decision; Primary Fiduciaries are required to promote independence and **reduce bias** in the handling of employees' assets. This means Primary Fiduciaries are expected to find out where conflicts of interest exist between their plan and its service providers. An assurance assessment from experts that do not offer investment, administration, or custodian services can easily and quickly identify where conflicts of interest exist and what should be done to manage them. The results nearly always increase confidence levels for Primary Fiduciaries, improve vendor relations, and most important, ensure better outcomes for retirement plan participants.

## PROFESSIONAL FIDUCIARIES ENJOY UNIQUE BENEFITS

The growing demands for better retirement plan results, greater competency, and the need for a professionally minded approach increase the demand for executives who prove their excellence as fiduciaries. More than just resume building, though, performance at a high standard of care produces other benefits. Few opportunities in life present the chance to serve others like that offered as a financial fiduciary. Beyond the peace of mind that comes with minimizing risk and maximizing stakeholder benefits, the achievement of proficiency is great for the soul. Good intentions alone, however, do not make a good steward. Equipping oneself with knowledge, surrounding oneself with independent thinkers, and cultivating the requisite skills are key steps for those who seek to enjoy the world of benefits as a professional fiduciary.

## NOTES:

[1]ERISA (Employee Retirement Income Security Act) governing sponsors of qualified retirement plans. UPIA (Uniform Prudent Investor Act) governing trusts. UPMIFA (Uniform Prudent Management of Institutional Funds Act), governing nonprofit organizations (endowments and foundations) directors and executives.