THE EXCELLENT FIDUCIARY

The Bumpy Road to Fiduciary Excellence

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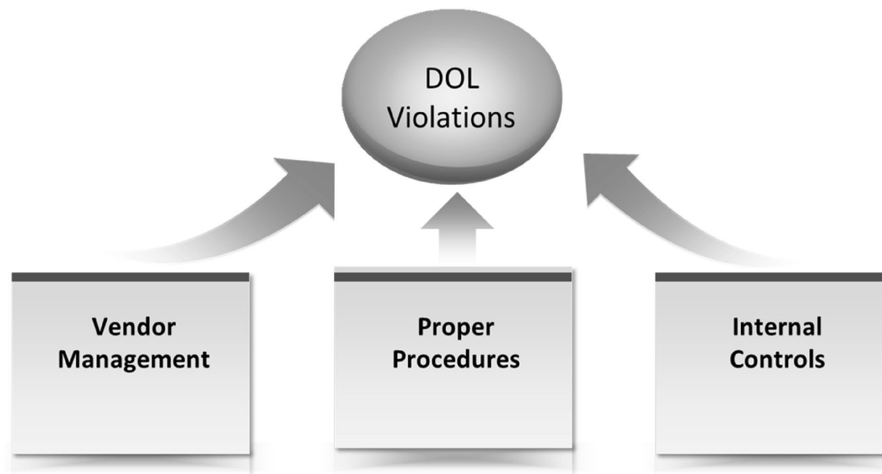
THREE COMMON TRAITS OF FIDUCIARY RISK

C-suite executives and senior managers know they are confronted by legal risks, but they often are unable to articulate the specific causes, how to isolate them, or what exposure to fiduciary risk means to their organization. Identifying the key causes is a good place to start.

The DOL has identified the most common violations of ERISA fiduciary duty. These three major categories include: ***Vendor Management***, ***Proper Procedures***, and ***Internal Controls***. Within each of these areas, we will provide plan sponsors practical strategies for protecting themselves against DOL scrutiny and serving as a confident steward of their employees' assets.



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But first, what does a mistake in these areas cost an organization? ERISA violations that are discovered through a DOL retirement plan audit can result in significant monetary penalties. These fees are an attempt to return "lost" assets to retirement plan participants, who are not held responsible for fiduciary missteps made by their organization's executive team. An example of a recent federal mandate from the DOL required the president of Clark Graphics, an Ohio-based organization, to restore more than $500,000 to the company's two employee retirement plans.[1] This lawsuit claimed that the company's owners failed in their fiduciary responsibilities by 1) neglecting to properly monitor the plans' administrator (i.e., ***Vendor Management***), 2) not requiring the plan administrator to issue participant statements (i.e., ***Proper Procedures***), and 3) failing to review and reconcile the plans' trust account statements and review participant distribution calculations (i.e. ***Internal Controls***).

Violations in these three major fiduciary categories can be costly to an organization's bottom line and reputation—both internally with its employees and externally with its clients and partners. Implementing a few simple practices can help elevate an organization's fiduciary processes and safeguard against legal risk.

Fiduciary Risk #1: Vendor Management

The relationships between ERISA qualified employee benefit plans and their plans' vendors are the source of the greatest impediment in an organization's pursuit of fiduciary excellence. The DOL ranks vendor management at the top of its list of threats to an ERISA plan's safety. The reason the DOL has warned plan sponsors specifically about their retirement plan vendors is that there has been a historical information gap between fiduciary vendors and plan sponsor executives. Because the investments and administration industries are complex and fee structures are often hard to discern, corporate plan sponsors face an immediate disadvantage in understanding the intricacies of these vendor arrangements. Furthermore, vendors' fees and quality of services are not examined in most plans commensurate with how vendors of traditional business services are evaluated, as the hiring and retention decisions for investment and recordkeeping services are most often made by managers who are not trained procurement professionals. While plan sponsors by law are required to do what is best for their retirement plan participants (i.e., the definition of "fiduciary duty"), retirement plan vendors are perfectly within their legal scope to serve only their/their organization's own financial interests. This historical misalignment of standards of care has widened the information gap between vendors and sponsors, delivering a heavy burden to plan sponsors who are responsible for selecting, monitoring, and evaluating those retirement plan vendors serving their employees.

Failing to properly select and monitor service providers is also the catalyst in the class action lawsuits that continue to be filed against ERISA plan sponsors and their key executives with the 403(b) market now under assault. Plan sponsors today should seek to put into place a simple process related to vendor management to help mitigate their risk, which may include:

1. Confirming they receive ERISA Section 408(b)(2) fee disclosures from vendors on a regular, timely schedule.
2. Examining these vendor disclosures for adequacy and requesting clarification where needed.
3. Proving that vendor fees are reasonable through a third-party assessment.

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4. Engaging in an annual vendor value examination to ensure vendor service quality aligns with vendor fees. (An example of a third-party vendor assessment is Roland¦Criss' Vendor Value Index™, found here: http://rolandcriss.com/what-we-do/services/erisa-fee-assessment/vi-description/).

Fiduciary Risk #2: Proper Procedures

Under ERISA, employee benefit plan managers must ensure that their decision-making and operations management follow a "prudent process." Such a process is not merely an attitude; ERISA requires that it be evidenced by written procedures.

So why don't all plan sponsors have a written procedure in place? There are many reasons executives overlook or even dismiss the importance of creating a formal process for the management of their retirement plans. Common explanations (and rebuttals based on DOL requirements) include:

- "Things are running smoothly, so there is no need to take the time to develop written procedures. My department is stretched too thin complying with other regulatory programs for us to focus much on ERISA." *(DOL Rebuttal: Even if things are running smoothly, ERISA requires written documentation of how and why decisions are being made related to the retirement plan.)*
- "Our vendor (recordkeeper/investment advisor) provides a fiduciary system and manages it for us." (*DOL Rebuttal: Vendors can conceal conflicts of interest, which disqualifies their "fiduciary solution" as a substitute for the plan sponsor management process. Fiduciary responsibility lies solely with the named plan fiduciary within the organization; thus, the oversight process must reside with that party.)*
- "The DOL has never audited us and has never questioned how we manage our ERISA plan." *(DOL Rebuttal: With a heightened level of DOL investigations, regulation, and whistleblower activity in this space, the documentation of a prudent process is the single most important step in mitigating corporate risk, establishing ground rules with vendors, and safeguarding corporate leaders from heavy penalties and fines.)*

Although the subject of "procedures" is rarely a tantalizing one, it is particularly vital in the arena of retirement plan management as it drives alignment with critical fiduciary standards of care. Written procedures not only provide necessary risk mitigation in the event of a DOL audit or legal investigation, but they ensure that retirement plan managers are acting as responsible stewards of their employees' assets. A written process maximizes efficiency, communication, and understanding across internal teams and departments that play a role in the retirement plan management, whether it is regarding how to oversee retirement plan vendors, document necessary day-to-day practices, or identify pertinent data required for investment committee meetings.

The desire to develop fiduciary procedures is not absent across the employee benefit industry, but the know-how is a challenge for many organizations. The lack of a documented workflow has led executives and employee benefit committees to violate ERISA's fiduciary standards of care in three common ways:

1. Failing to operate the plan prudently and for the ex-

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clusive benefit of participants.

2. Using plan assets to benefit certain related parties to the plan, including the plan administrator, the plan sponsor, and parties related to these individuals.

3. Failing to follow the terms of the plan as outlined (assuming they are consistent with ERISA mandates).

For plan sponsors seeking to ensure their current practices align with fiduciary requirements under ERISA, an independent third-party ERISA Governance, Risk Management, and Compliance ("GRC") consultant can provide a prudent process template—or walk hand-in-hand to implement the entire process—that has the ability to instantly upgrade an organization's fiduciary standing and secure stewardship peace of mind.

Fiduciary Risk #3: Internal Controls

Fiduciary risk management is heavily dependent on a system of internal controls. Such controls help executives and managers that oversee qualified benefit plans understand the risks they are exposed to and establish surveillance steps that counter threats. An internal controls program, built around fiduciary standards of care, is essential for mapping the journey to fiduciary excellence. In today's world, an ERISA based GRC system of internal controls is a risk management imperative. Indeed, with proper internal controls practices in place, fiduciary risks #1 and #2 discussed in this article (vendor management and proper procedures, respectively) can be simultaneously and proactively addressed.

A plan sponsor may put in place internal controls around the organization's retirement plan management process by following three primary steps:

1. *Conduct an Assessment.* An assessment of current fiduciary practices identifies specific risks to the employer and the plan's participants, and defines how each category of risk should be managed. Since ERISA lacks specific steps for this assessment, plan sponsors can begin this process by downloading a set of best practice steps published through the The Investment Fiduciary Leadership Council (a fiduciary standards organization), at www.iflcouncil.org/index.php/standards-rpa.

2. *Consolidate Key Data Sources*. In order to have coherent and dependable internal controls for an ERISA plan, the organization must embrace all of the records and the sources on which an assessment is based. These records should be identified and kept in a centralized organizational space (electronically or physically) for ease of reference and updating. Necessary records include:

   - The plan's management guide (i.e., the "Plan Document");
   - Governance policies;
   - Administration procedures;
   - Investment decision making parameters;
   - Minutes of fiduciary committee meetings;
   - Recordkeeping/TPA vendor's reports;
   - Investments provider(s)' reporst; and
   - Records archive.

3. *Define Control Steps*. Certain "tests" should be implemented to ensure that appropriate operations and management activities are carried out consistently across orga-

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nizational and vendor boundaries. Major activities that should be tested on a regular basis include:

- Decision making authorizations;
- Division of duties;
- Vendor selection and performance reviews;
- Physical access to premises and participant data; and
- Cybersecurity.

In order to ensure the effectiveness of internal controls, a periodic examination by a fiduciary risk management specialist should be conducted. A properly constructed and consistently monitored system of internal controls is a common trait found in excellent fiduciaries. What's more, such a system is the best tool for meeting the legal challenges to fiduciary conduct potentially instigated by regulators or plan participants.

CONCLUSION

The three risk areas on the road to fiduciary excellence are not small potholes to dodge—particularly for busy executives who are also tasked with the enormous responsibility of managing their company's human resource and finance functions. The DOL has worked to mandate higher standards and specific fee reporting for retirement plan vendors in order to assuage this burden on plan sponsors. However, as the law stands today, retirement plan sponsors are still the primary party held responsible for prudently overseeing how their employees' retirement accounts are being handled. This means that plan sponsors should adopt written processes and controls that clearly articulate vendor expectations, as well as decision-making criteria for every step in their retirement plan management process—to protect themselves, their organization, and their employees.

While setting up these internal fiduciary processes may seem daunting, there is no better time to pursue this endeavor. Given the DOL's increasing focus on the retirement plan industry, there are myriad templates, best practices, and benchmarking standards available for those plan sponsors who desire efficient, effective solutions to their ERISA compliance and stewardship peace of mind. Plan sponsors should be diligent to vet third-party fiduciary consultants to ensure they are industry certified and lack any conflicts of interest that would inhibit implementing an objective, best-practice fiduciary process for their plan sponsor clients. The road to fiduciary excellence can be easily navigated with the right companions along for the ride. For more fiduciary tools, templates, and tips, visit http://www.rolandcriss.com/.

NOTES:

[1]U.S. Department of Labor press release, "US Labor Department action results in order to restore half a million dollars to worker retirement plans sponsored by Columbus, Ohio-based company." https://www.dol.gov/opa/media/press/ebsa/ebsa20121122.htm.

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