



A Fiduciary's Guide: Creating a Dependable Due Diligence Decision-Making Process

THE SUCCESSFUL FULFILLMENT OF FIDUCIARY DUTIES is critical to the proper protection and performance of the financial assets for which fiduciaries are accountable. Unfortunately, they often may not know what their specific duties are, nor their potential liability should they fail to satisfactorily perform this role. Since a pension plan fiduciary's lack of knowledge can be detrimental both to the company (the plan sponsor) and to its employees (the plan participants), Bidart & Ross, Inc. is pleased to offer the following background and suggestions for pension plan fiduciaries.

BACKGROUND: The Fiduciary's Role

The role of a pension plan fiduciary is governed by the US Department of Labor under the Employee Retirement Income Security Act of 1974 (commonly known as ERISA). Per ERISA, pension plan fiduciaries must, in the course of their duties:

- Act only in the provision of retirement benefits to plan beneficiaries
- Put the plan beneficiaries' interests unquestionably above their own or any others'
- Minimize plan expenses, including avoiding all unnecessary expenses (this helps prevent the value of plan assets from eroding over time which can reduce the benefits available to plan participants)
- Act according to all prudent and commonly accepted principles of financial and benefits

management, including appropriate diversification of assets (to reduce the potential of large losses)

- Observe the plan charter and all other investment committee policies, to the extent that they comply with ERISA¹

These rules don't necessarily mean that fiduciaries are expected to see the future any better than their peers. But, these rules do mean that fiduciaries are fundamentally obligated to make prudent decisions based on careful evaluation, according to the prevailing standards of the day. From a financial point of view, this means selecting and maintaining an appropriate portfolio allocation, choosing prudent investments within that portfolio, and measuring individual investment results against the financial marketplace. From an administration point of



view, this means selecting appropriate plan service providers to administer the necessary functions of the plan, including accounting and reporting, plan participant enrollment and communications, etc. Further, a periodic review should be conducted to adapt to improvements or other changes offered in the market for investment vehicles and/or administrative services.

Pension plan fiduciaries must be aware that ERISA holds them personally liable for any breach of these duties, which includes an obligation to personally restore any losses suffered by the plan as a result of the breach (including any profits lost), in addition to any court-ordered remedy.² This regulation applies equally to the selection of investments and of plan service providers. However, the Department of Labor (DOL) Pension and Welfare Benefits Administration has clearly stated how a fiduciary may satisfy any investment duties within the pension plan. Specifically, fiduciaries must evaluate the risk of loss against the opportunity for gain, as well as plan diversification, liquidity, current return relative to cash flow needs, and projected return relative to funding objectives, according to standards prevailing at the time.³

RECOMMENDATIONS: Steps to Take

Based on our experience, and given the potentially severe consequences of breaches of fiduciary duties, Bidart & Ross, Inc. recommends the following approach to pension plan management in order to effectively fulfill fiduciary obligations to plan participants:

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1. How to select fiduciaries for your plan

Create a committee that's dedicated to issues directly related to your retirement plan(s). You'll want a member count sufficient to allow for a formal quorum at every quarterly meeting, to ensure issues can be reviewed and decisions made. Members should be appointed by the company owner or Board president. They should represent diverse fields, including human resources, finance and benefits. Once you've identified your members, educate each one about their duties, using inside or outside counsel, as necessary. Give each of your fiduciaries a copy of pertinent ERISA and DOL information, to ensure their familiarity with the governing statutes.

2. Establish a formal Statement of Investment Objectives and Guidelines

This critical document establishes a well-thought-out benchmark for prudently selecting and monitoring your plan's investment and administration providers.

Key elements include:

- The intent of the retirement benefit
- How it should function within the overall benefits structure
- How providers will be chosen and monitored

The guidelines should contain the following:

- I Benefit Introduction and Purpose
 - a. Is the plan intended to be 404c compliant? (i.e., will participants have any investment choices with regard to their individual retirement funds, or will all funds be centrally controlled?)



II Definition of Investments

- a. Outline of the investments/asset classes to be offered
- b. Investments evaluation standards (qualitative and quantitative)
- c. Guidelines for investments selection and replacement
- d. Definition of Administrative Functions
- e. Record keeping standards
- f. Communications standards
- g. Fees and disclosure practices

Your committee should evaluate these guidelines annually to ensure they meet the standards outlined. If the committee proposes changes to the investment lineup or the evaluation criteria, then the guidelines should be amended to reflect those modifications.

3. Create goals for each year

Goals should relate to specific aspects of the retirement benefit. They may specifically address committee-identified weaknesses, changes in the marketplace, or pertinent legislative issues. Incorporate at least one or two relevant goals into the committee's activities each year.

The responsibilities of a pension plan fiduciary can appear overwhelming, particularly when one lacks sufficient qualifications to knowingly fulfill them. Plan fiduciaries are required to make binding decisions regarding complex situations with very real outcomes for plan participants. In order to adequately fulfill their duties, ERISA requires that untrained fiduciaries employ outside help.

Bidart & Ross, Inc. is a completely independent and unbiased financial consulting firm that can help you successfully fulfill your role as a pension plan fiduciary. For more information please call (775) 826-6400 or visit www.Bidart-Ross.com.

¹Fiduciary Duties. USC 29 Chapter 18 Subchapter I Subtitle B Part 4 § 1104a. 10 Sep 2007.

<<http://www.law.cornell.edu/uscode/html/uscode29/usc_sec_29_00001104----000-.html>>

"A fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and—

- (A) for the exclusive purpose of:
 - (i) providing benefits to participants and their beneficiaries; and
 - (ii) defraying reasonable expenses of administering the plan;
- (B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
- (C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and
- (D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter and subchapter III of this chapter."

²Liability for Breach of Fiduciary Duty. USC 29 Chapter 18 Subchapter I Subtitle B Part 4 § 1109a. 10 Sep 2007.

<<http://www.law.cornell.edu/uscode/html/uscode29/usc_sec_29_00001109----000-.html>>

"Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this subchapter shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary."

³Department of Labor, Pension and Welfare Benefits Administration. Rules and Regulations for Fiduciary Responsibility – Investment Duties. USC 29 CFR 2550.404a-1. 10 Sep 2007.

<<http://www.dol.gov/dol/allcfr/Title_29/Part_2550/29CFR2550.404a-1.htm>>

- (A) In general. Section 404(a)(1)(B) of the Employee Retirement Income Security Act of 1974 (the Act) provides, in part, that a fiduciary shall discharge his duties with respect to a plan with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.
- (B) Investment duties.
 - (1) With regard to an investment or investment course of action taken by a fiduciary of an employee benefit plan pursuant to his investment duties, the requirements of section 404(a)(1)(B) of the Act set forth in subsection (a) of this section are satisfied if the fiduciary:
 - (i) Has given appropriate consideration to those facts and circumstances that, given the scope of such fiduciary's investment duties, the fiduciary knows or should know are relevant to the particular investment or investment course of action involved, including the role the investment or investment course of action plays in that portion of the plan's investment portfolio with respect to which the fiduciary has investment duties; and
 - (ii) Has acted accordingly.
 - (2) For purposes of paragraph (b)(1) of this section, "appropriate consideration" shall include, but is not necessarily limited to,
 - (i) A determination by the fiduciary that the particular investment or investment course of action is reasonably designed, as part of the portfolio (or, where applicable, that portion of the plan portfolio with respect to which the fiduciary has investment duties), to further the purposes of the plan, taking into consideration the risk of loss and the opportunity for gain (or other return) associated with the investment or investment course of action, and
 - (ii) Consideration of the following factors as they relate to such portion of the portfolio:
 - (a) The composition of the portfolio with regard to diversification;
 - (b) The liquidity and current return of the portfolio relative to the anticipated cash flow requirements of the plan; and
 - (c) The projected return of the portfolio relative to the funding objectives of the plan."