Fiduciary Series

Investments—designing and monitoring your plan menu

Participants rely on your plan's investment options to help them pursue a secure retirement. And for many, the plan will be their main source of retirement income. That's why it's so important that you meet your fiduciary responsibilities to carefully select and monitor suitable plan funding choices for your plan.

As a fiduciary, you should keep in mind the following points needed to fulfill your obligations:

- ERISA generally requires the diversification of plan investments.
- A prudent investment selection and monitoring process is necessary.
- Diligent and regular investment reviews and adjustments should be part of a prudent process.

The following two plan design guidelines can help you meet ERISA's requirements:

#1: Select suitable plan investment options

A well-designed investment menu should fit your employees' needs and help to provide the income they will need in retirement.

Litigation for poor investment choices is on the increase. Plan fiduciaries who do not comply with ERISA's fiduciary standards can be held personally liable for losses caused by their failure to perform their duties. Such fiduciaries could face penalties and sanctions because of improper investment selection.

Reducing your liability

ERISA section 404(c) can help relieve you of fiduciary liability for participant investment decisions. To receive this protection, you must offer at least three investment options that give participants sufficient opportunity to diversify their savings. Bear in mind, however, you're still responsible for the prudent selection and monitoring of the funding options.

Make prudent investment menu selections

When designing your investment menu, make sure you follow your investment policy statement (IPS) and satisfy ERISA's diversification requirement. As a best practice your investment menu options should:

- Be easy to understand
- Be diversified and allow employees to build portfolios based on their situations and goals
- Address both the accumulation and income phases of retirement planning
- Include professionally managed investment options for participants that aren't active in their retirement planning

Here are some steps you can take to help you meet your investment fiduciary responsibilities:

Create and document your process

Consider creating and following an investment policy statement (IPS). Your IPS should clearly spell out a process for selecting and monitoring your plan menu options and service providers. While an IPS isn't required, it's considered a best practice and will help serve as proof of your fiduciary process if you follow it. A trusted provider or consultant can help you create your IPS by offering guidelines, providing sample templates and helping you draft it.

Watch your numbers

More isn't necessarily better when it comes to the number of investment choices you offer. Too many choices may confuse participants, or worse, it may keep them from investing because they are overwhelmed.

A well-constructed investment menu contains enough choices to suit a variety of investing preferences and meet a range of objectives. Your menu might include:

- Target-date funds, which simplify asset allocation (Please note that target date funds include a target date that approximates when investors plan to start withdrawing their money. The principal value of the funds is not guaranteed at any time, including at the target date. Target-date funds share the risks associated with the types of securities held by each of the underlying funds in which they invest. In addition to the fees and expenses associated with the target-date funds, there is exposure to the fees and expenses associated with the underlying mutual funds as well.)
- Mutual funds, which allow participants to diversify broadly and create their own mix
- Lifetime income solutions such as annuities, which can, as one of the income options, provide guaranteed* income for life to help your participants meet their basic needs in retirement

To avoid confusion and promote good planning habits, make sure you give your employees access to the information they need to make informed investment decisions. And deliver this information in a format that's easy for them to compare plan investment options—as required by the Department of Labor's fee disclosure regulations. You should also carefully evaluate each fund's expenses against the potential value of what an investor receives in return.

#2: Properly monitor plan investment options

Selecting suitable investment options is part of the challenge; you also need to monitor and review these options regularly. Otherwise, you might find that your funds are no longer managed according to their objectives, are underperforming, or are charging higher than average fees. Improper monitoring may put you personally at risk for penalties and sanctions.

* Guarantees are based on the claims-paying ability of the issuer.

Here are some tips to help you monitor your plan:

Conduct regular plan investment reviews

Thoroughly review your plan's investment menu at least annually—more often if market conditions, provider concerns or participant issues warrant—and document your monitoring/review process carefully. The idea is to clarify how well your investment options are working and identify areas that need improvement. Make sure you:

- Review each investment option against benchmarks
- Evaluate whether each fund is still suitable for your menu
- Monitor fund costs and understand their impact

Follow your investment policy statement

Make sure you're following the terms of your IPS as you run through your annual fund review. As part of the review process, pay special attention to your IPS's guidelines about when to place funds on a watch list. These guidelines should also dictate when to inform participants about fund concerns or potential changes. As always, be sure to document everything carefully.

Seek expert assistance

Consider collaborating with a service provider who offers a high level of fiduciary support. A third-party provider can help you with:

- Investment policy statements
- Investment menu design
- Investment selection and monitoring

But if you do work with a third party, remember that it's still your fiduciary responsibility to prudently select and monitor that plan provider. There are different types of third-party investment fiduciaries so make sure you understand what, if any, fiduciary responsibilities they are assuming. Sometimes, demonstrating your fiduciary prudence means enlisting the services of experts—whether it's a trusted plan provider, independent fiduciary or consultant.

Having a well-thought and documented process to select and monitor your plan's funding choices will help you fulfill your plan obligations. It can also help your employees prepare for retirement and pursue lifetime income.

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