Fiduciary Responsibility Series:

Investments: Laying a foundation for lifetime income

Your participants rely on their investments in your retirement plan to achieve a secure retirement. In fact, for many, the plan will be their main source of retirement income. This makes your fiduciary responsibility to carefully select and monitor suitable investment choices extremely important.

As you consider this responsibility, you need to be mindful of 1) ERISA's fundamental diversification requirements, 2) the need for a prudent investment selection and monitoring process, and 3) the need for diligent and regular investment reviews and adjustments to meet changing realities.

Fiduciary mistakes related to improper selection and monitoring of plan investments are all-too common. But they are also preventable. It's well worth your time and effort to avoid these mistakes and the possibility that your participants will suffer unnecessary investment losses that may undermine their retirement readiness.

Mistake #1: Improper selection of plan investment alternatives

Designing an investment menu with choices that make sense to and for your employees, as well as offer them plenty of diversification potential, is essential to their retirement readiness. Just as important, it could help minimize your fiduciary risk.

That's significant given that ERISA holds plan fiduciaries *personally* liable for losses in the plan resulting from a failure to perform their duties. The costs could be major. Penalties and sanctions are possible consequences of improper investment selection.

What's more, litigation on behalf of participants who have suffered investment losses has grown over the years, whether it relates to poor investment choices or excessively high fees. In short, you must take your responsibility for investment selection seriously. Here are some ways to avoid selecting improper investments for your plan.

Create and document your process
Mistakes occur more often in the absence of a clear process. That's why building your investment menu should start with creating and following an investment policy statement (IPS) that spells out guidelines for selecting and monitoring your plan menu options and service providers. While an IPS isn't required, it's certainly considered a best practice and can go a long way toward helping you avoid costly fiduciary missteps. For this reason, you should use your IPS to guide the selection of your investment menu options and document the process as proof of your fiduciary process. A trusted provider or consultant can help you create your IPS by offering guidelines, providing sample templates and even helping you draft it.

Make prudent investment menu selections
When designing your investment menu, in addition to remaining consistent with your IPS, keep in mind ERISA's requirement to diversify the plan's investments as a way to avoid large losses. To address this mandate and meet the needs of your participants, make the following features a part of your investment menu:

- Provide a range of asset classes and styles with minimal overlap so investors can easily understand their choices and implement their asset allocation decisions.
- Include choices that allow for broad diversification so that investors of all types can balance risk and return based on their unique needs and circumstances.
- Offer investment options that cover both the accumulation and distribution phases of retirement planning, including guaranteed lifetime income options such as annuities.

In the first issue of the **Fiduciary Responsibility Series**[1] we introduced ten "common fiduciary mistakes" — obstacles to fiduciary responsibility that may have damaging consequences. In this and other installments, we take a deeper look at these fiduciary missteps, grouped in four categories:

Plan documents: Plan document failures and failing to understand and follow restrictions in the plan's funding vehicles

Disclosures to participants: Failing to disclose plan changes to participants and providing inadequate investment education and fee disclosure

Investments: Improper selection and improper monitoring of plan investment alternatives (this issue)

Fiduciary governance: Selection of plan fiduciaries; improper delegation of fiduciary functions; undue reliance on an "expert;" fidelity bonds and fiduciary liability insurance

- Include target date lifecycle funds that simplify investment decision-making. These could be used as your qualified default investment alternative (QDIA) to improve the asset allocation for new participants who fail to provide investment instructions for their contributions.

Investment menu selection is one of the most challenging aspects of retirement plan maintenance. If you're not comfortable choosing the investments that meet ERISA requirements, consider covering your responsibility to act prudently by working with a third party. When deciding to go this route, be sure to be clear in your expectations of a third party and their assumed fiduciary responsibilities, if any. Certain third parties, such as 3(21) and 3(38) fiduciaries, assume different levels of fiduciary responsibility regarding the selection and monitoring of your investment options. If you do hire a 3(21) or 3(38) fiduciary, it is important to remember that you still have a fiduciary responsibility to select and monitor that third party.

Watch your numbers
More isn't necessarily better with respect to the number of investment choices you offer. While variety and diversity are important, you don't want to confuse participants with too many choices, or worse, keep them from investing because they can't make a decision.

A well-constructed investment menu contains enough choices to suit a variety of investor personalities and meet a range of objectives — from long-term growth to lifetime retirement income. Such a menu might include:

- Target date funds, which simplify asset allocation
- Mutual funds, which allow participants to diversify broadly and create their own mix
- Lifetime income solutions such as annuities, which provide guaranteed income for life so that your participants can meet their basic needs in retirement

To avoid confusion and promote good planning habits, give your employees access to the information they need to make informed investment decisions. Be sure to deliver this information in a format that allows them to easily compare plan investment options – as required by the DOL's new fee disclosure regulations.

On the subject of fees, carefully evaluate each fund's expenses, weighing these costs against the potential value of what an investor receives in return. To learn more, see our paper, **Assessing Reasonableness of 403(b) Retirement Plan Fees**.

Ultimately, with a prudent, carefully documented process to demonstrate how and why each investment is a good fit for the overall plan – and in the best long-term interests of participants — plan sponsors can be confident that their lineup is consistent with their fiduciary obligations.

Mistake #2: improper monitoring of plan investment alternatives

Selecting suitable investment options is only half the battle. Of equal importance is monitoring and reviewing these options — regularly, carefully and thoughtfully. Failure to do so could cause you to miss style shifts, performance issues or costs that could be problematic for your participants. Because failure to monitor your plan investments puts you at risk for penalties, fines and sanctions similar to those for improper selection, consider these ways to avoid this fiduciary mistake.

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

- Review the performance of each investment option versus established benchmarks and peers.
- Examine the role of each fund in your investment menu, with respect to suitability for your employee population as well as the diversification/asset allocation opportunity it offers.
- Monitor fund costs — keeping in mind that, while the lowest fees don't necessarily mean the greatest value, over time, fund

ERISA 404(c)

While compliance with ERISA 404(c) isn't mandatory, it does provide an opportunity to relieve you of fiduciary liability for participant investment decisions. In order to comply with 404(c), you must offer at least three investment options that give participants sufficient opportunity to diversify their savings.

costs can impact a participant's return. So carefully weigh these costs in the course of your annual review.

A trusted service provider can help by offering research, services and guidelines to help you monitor and review your funds from both a performance and cost perspective.

Follow your investment policy statement
Make sure your annual fund review confirms your menu's continuing compliance with your investment policy statement — particularly if you are concerned about certain funds. Your IPS should spell out procedures for when to place funds on a watch list, allowing "appropriate ambiguity" for fiduciaries to evaluate special circumstances. Your watch list procedures should also dictate when to inform participants about fund concerns or potential changes. And, as always, be sure to document everything carefully.

Seek expert assistance
Investment-related fiduciary mistakes could be easily made – but they're just as easy to avoid, given proper procedures for selecting, monitoring and adjusting your plan's investments. Considering the consequences of these mistakes, look to the experts for support. Think about partnering with a service provider who offers a high level of fiduciary support, including investment policy statement services, plan investment menu design assistance, and even objective advice to help your employees make informed investment decisions. Do your best to recognize when it may be more efficient to demonstrate fiduciary prudence by relying on the services of experts — whether it's a trusted plan provider, independent fiduciary or consultant.

It's your participants' retirement at stake, and your fiduciary responsibility to make sure they can invest properly for it.

In the next issue of our Fiduciary Responsibility Series, we will address fiduciary mistakes related to plan governance.

Explore further

For more on this topic and on how fiduciaries can address the challenges they face, visit our **Fiduciary Responsibility Series** site.[1]

The importance of lifetime income options

72% of participants surveyed are interested in contributing to an investment option within their 401(k), 403(b), or 457 plan that focuses mainly on generating a guaranteed monthly income in retirement.[2]

While most plans include options that help employees accumulate assets during their working years, more should consider guaranteed options to provide participants with income that covers essential expenses in retirement.

[1] Direct link - **www.tiaa-cref.org/public/plansponsors/news/views-and-commentary/fiduciary-responsibility-series**

[2] Retirement Research Inc./Brightwork Partners, 2011.

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Diversification is a technique to help reduce risk. There is no guarantee that diversification will protect against a loss of income. Rebalancing does not protect against losses or guarantee that an investor's goal will be met.

Please note that Target Date/Lifecycle Funds include a target date that approximates when investors plan to start withdrawing their money. The principal value of the fund(s) is not guaranteed at any time, including at the target date.

Guaranteed income is subject to the claims paying ability of the issuing insurance company.

You should consider the investment objectives, risks, charges and expenses carefully before investing. Please call 877-518-9161, or go to www.tiaa-cref.org for a current prospectus that contains this and other information. Please read the prospectus carefully before investing.

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