Fiduciary Responsibility Series:

Governance — a framework for sustaining fiduciary responsibility

TIAA CREF

With increased regulator focus on plan compliance, and the DOL's interest in 403(b) plan fiduciary issues, effective plan governance is increasingly essential to accurate and compliant plan management.

What is governance?

Plan governance is a framework of processes for oversight and monitoring. This framework can help you maintain your institution's strategic objectives and direction, as well as manage your fiduciary and compliance obligations. An effective retirement plan governance program incorporates processes for all duties and responsibilities involved with sponsoring your plan, and helps reinforce and maintain established plan objectives.

Proper governance encompasses all plan-related activities. Such activities include identifying plan fiduciaries and delegating responsibilities; relying on experts; and honoring fidelity bonding requirements. These, and more, are all part of good governance.

Above all, process and procedure should drive fiduciary decisions, and sponsors should meticulously document every step of the decision-making process. Thorough documentation, in particular, demonstrates due diligence, serves as a valuable permanent record, and helps fiduciaries to know their roles and carry them out properly. Importantly, the courts and the DOL will look to see if a prudent process was used and documented — regardless of the outcome — when determining if a breach occurred. The Internal Revenue Service also considers a plan's internal controls in determining the scope of its examination.

Absent this due diligence, even the most prudent plan sponsor can make fiduciary mistakes that may lead to:

- *Personal* liability for losses to the plan resulting from breach of fiduciary duty
- Legal action from the DOL, a participant or beneficiary
- Fines for a fiduciary breach resulting in financial loss
- Plan or contract disqualification
- Increased audit scrutiny
- Higher operating expenses

Following are some of the most common fiduciary mistakes that are avoidable with proper plan governance. Naturally, sponsors should work with their provider or consultant to help develop, implement and coordinate a thorough and comprehensive governance process. For additional help with the governance process, sponsors can also consult with their legal counsel for advice.

Mistake #1: Improper selection of plan fiduciaries

It's critical that you establish appropriate plan committees to provide fiduciary oversight and keep plan fiduciaries on track with their responsibilities relative to investments, fees and administrative duties. It's also important that the committee selection process is consistent with what you have documented. What's more, committees tasked with key areas of fiduciary responsibility, such as an investment committee to oversee investment selection and review, can limit the liability of your board members. Committee members should:

- Have the expertise needed to act as a fiduciary in the capacity for which they are chosen
- Fully understand their responsibilities (be sure to define and communicate their roles)
- Be willing to make the commitment to and be actively engaged in their roles

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

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

Having this committee meet periodically and asking them to approve and sign meeting minutes allows you to hold your fiduciaries accountable for reviewing plan operations, identifying and correcting defects, as well as establishing internal controls.

Prudent selection and training can minimize risk

Selecting fiduciaries who lack the appropriate expertise or commitment to their responsibilities could put you at greater risk of a fiduciary breach. Accordingly, how you identify, select and train your plan fiduciaries, as well as how you evaluate or even replace them, should be thoughtful and follow a clear process, consistent with your plan document or other policies and procedures.

Keeping your fiduciaries informed and educated can help avoid costly mistakes. Periodic training and education keeps your fiduciaries apprised of regulatory and retirement plan industry developments, and, most importantly, allows them to make informed fiduciary decisions. Such training should cover a broad range of topics including investments, fiduciary duties, plan governance, plan documents, monitoring outside service providers and participant communications.

Mistake #2: Improper delegation of fiduciary functions

Performing an activity — rather than a formal designation — is the determining factor for who is and is not considered a plan fiduciary. That's why being aware of their responsibilities and the potential risks for noncompliance is just as important for those who perform fiduciary functions as for those who are named fiduciaries. You should be mindful and consider fiduciary responsibility when assigning roles within the plan.

As you identify plan fiduciaries, consider reporting structures carefully. You want to avoid duplication of effort but also be sure that nothing slips through the cracks. For this reason, be sure your fiduciaries understand who has which responsibilities so that no task goes uncompleted. Remember, fiduciaries can have potential liability for the actions of their co-fiduciaries, if they participate in a breach, conceal it or fail to help correct it.

One critical aspect of delegating fiduciary functions is to make sure that the individuals you delegate these responsibilities to are fully aware of their status as fiduciaries, acknowledge their role and recognize the potential liability for not meeting these duties. Once again, clear processes and full documentation should be your best practices in protecting against fiduciary breaches.

With respect to process, your plan can allocate fiduciary roles under ERISA. Most commonly, administrative and investment responsibilities are delegated separately. In addition, you should document your allocation procedures in either your plan or a separate governance document.

Done properly, delegation of fiduciary functions will result in each fiduciary understanding his or her role along with the fact that his or her potential liability will be limited to the performance of that role. On the other hand, improper delegation of fiduciary functions could drag a fiduciary into controversy and defense of a case that can become both burdensome and expensive.

Mistake #3: Undue reliance on an expert

In the course of fulfilling your fiduciary responsibilities it is common practice to use the services of outside experts. The benefits can be significant, but the practice should be undertaken with prudence and within reason. Remember, selecting service providers is a fiduciary act, requiring due diligence and ongoing monitoring.

Under ERISA, a plan fiduciary should hire an expert if the fiduciary lacks the expertise needed to fulfill his or her responsibilities. ERISA permits fiduciaries to rely on expert opinions, but not "blindly."

That means a fiduciary must exercise prudence by examining whether the expert's assumptions are reasonable. Further, the plan fiduciary must take the time to understand the expert's advice and determine whether or not it is sensible to

Who is a plan fiduciary?

The role as fiduciary is based on function, not title. Your plan fiduciaries include *anyone* who meets *any* of these criteria:

- Is specifically named in the plan document
- Exercises discretionary authority or control over plan assets
- Exercises discretionary responsibility or authority over the administration of the plan
- Exercises discretionary authority or control of plan management
- Provides investment advice for a fee or other compensation

follow it. Along with this decision, the reasons for following or not following the expert's advice should also be documented.

When selecting outside experts, where appropriate, plan sponsors should consider a formal request for proposal. Information gained through this process will not only provide a basis for comparison but also allow the plan sponsor to judge what kind of expert advice might be "reasonable" for the plan to obtain.

Finally, given that many plan sponsors do hire third parties for professional support and expertise, it is important to clearly define roles and manage the activities that may be distributed among third-party administrators, consultants, vendors and recordkeepers.

Mistake #4: Failure to maintain fidelity bonds and fiduciary liability insurance

ERISA requires all fiduciaries and anyone else who handles plan assets to be bonded (fidelity bond) in order to protect the plan and its participants against loss from fraud or dishonesty. This bond must be at least 10% of the amount of funds managed or handled by the fiduciary up to a maximum bond amount of $500,000 or $1,000,000 for plans with employer stock.

Bonding is *required* for plans funded with plan-owned annuity contracts and mutual funds. It is *recommended* for plans funded only with individually owned/allocated annuity contracts.

Another optional protection to consider seriously is fiduciary liability insurance, which covers liability or losses arising from a breach of fiduciary duty. Remember, under ERISA, any plan provisions or agreements designed to relieve fiduciaries of their liabilities are essentially "null and void." Coverage is relatively inexpensive and quite broad.

Before buying fiduciary liability insurance, consider the following:

- Policies vary widely in their coverage, so choose a policy that covers the types of breaches relevant to your plan.
- Liability insurance includes both litigation and settlement costs up to the policy limit.
- The cost of coverage should not become impractical for your plan.
- If you buy liability insurance, your insurer still has the right to recover payments from the fiduciary responsible for the breach. So it is still possible for the plan or an individual fiduciary found to have performed dishonest acts to bear the cost of the loss.

Proper governance sets a framework for fulfilling fiduciary responsibilities effectively. It dictates who is responsible, holds them accountable and, when necessary, helps protect them in the event of fiduciary mistakes. As you consider your plan's governance, remember it is a dynamic process — one that you may need to update periodically to reflect organizational changes and/or regulatory developments.

What activities make someone a fiduciary?

- Selecting and monitoring plan investment vehicles
- Interpreting plan provisions
- Selecting and monitoring third-party service providers
- Providing investment advice for a fee
- Holding plan assets (trustee and/or custodian)
- Selecting other fiduciaries

Explore further

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

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

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