SEGAL ADVISORS

Spotlight™

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Post-PPA'06 Reviews of DC Plan Investments to Ensure Safe Harbor Fiduciary Protection

Sponsors of defined contribution (DC) retirement plans are facing new challenges in light of greater scrutiny of fees and expenses (accompanied by a movement for greater transparency),[1] an increased regulatory environment and additional plan administration and compliance requirements introduced by the Pension Protection Act of 2006 (PPA'06).[2] PPA'06 also provided additional steps that DC plan sponsors must take to be eligible for fiduciary protection under ERISA. Recently released final regulations on qualified default investment alternatives (QDIAs) explain and clarify a few of those steps. (The text box on the next page summarizes the news.) This *Spotlight* focuses on the fiduciary's role with respect to DC investment offerings.

What Are the Implications?

Sponsors of DC plans with participant-directed accounts that want to be protected by the ERISA §404(c) safe harbor must offer one of the PPA'06-mandated QDIAs. Plan sponsors with such accounts that are not seeking protection under the §404(c) safe harbor, should still consider the use of a QDIA, if they want fiduciary protection under ERISA. All DC plan sponsors, or the parties they name to oversee plan operations, serve in a fiduciary capacity and, as such, must follow appropriate standards of due diligence with respect to DC investment offerings.[3]

What Does Ensuring Safe Harbor Fiduciary Protection Now Entail?

All DC plan sponsors, especially those seeking fiduciary relief under the amended §404(c) guidelines, should consider the processes and tools described below to ensure prudent decision-making:

- ***Revisit Overall Plan Strategy*** Plan sponsors should ensure that the current investment lineup is consistent with established plan goals and objectives. The key is to identify the strengths and weaknesses of the investment program by answering the following questions:
  - What strategy or rationale have plan fiduciaries used to select investment options?
  - Are there unintended duplications of investment strategies?
  - Are certain asset classes not included or investment objectives not being met by the funds in the program? This can be determined though gap analysis.

  These questions are designed to determine the need to address and/or provide evidence of the plan sponsors' efforts to comply with ERISA's fiduciary standards in general, as well as with §404(c). Sponsors should also analyze the extent to which the investment policies have been carried out and how they have affected the actual results.

- ***Analyze Each Investment Option*** Plan sponsors should analyze each option in terms of asset class, objective, maturity, style and consistency with other options being offered and its popularity among the plan participants. They should also verify the investment style of each option, measure the risk characteristics and review expenses and returns.

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[1] This challenge was addressed in a February 2007 *Spotlight* published by Segal Advisors' strategic HR consulting affiliate, Sibson Consulting, A Division of Segal. That *Spotlight*, which Segal Advisors helped prepare, is available on the following page of Sibson's Web site: http://www.sibson.com/publications/spotlight/feb07DC.pdf

[2] The administrative and compliance challenges created by PPA'06 were the focus of Sibson's July 2007 *Spotlight* (http://www.sibson.com/publications/spotlight/july07PPAcompliance.pdf) and Sibson's September 2007 *Spotlight*, (http://www.sibson.com/publications/spotlight/sept07PPAadmin.pdf), respectively.

[3] Typically, either the employer itself or a committee of company executives appointed by the employer is the Named Fiduciary responsible for prudent management of the plan. For simplicity, this *Spotlight* refers to the plan sponsor as the fiduciary.

- ***Create an Investment Policy Statement or Revise an Existing Statement*** The creation and use of investment policies and guidelines should be carefully monitored and modified as part of an ongoing review. These guidelines provide the plan sponsor with a general framework for the program. In addition, the development and ongoing review of the investment policy statement is important because that document provides plan sponsors with concrete evidence that they are addressing their fiduciary responsibilities. It attempts to explain the plan's purpose, the responsibilities of all parties, the goal of investment communication/education, the monitoring and evaluation of fund options and the broad array of fund offerings and how they are selected/terminated.

- ***Form an Investment Committee and Formalize the Process under which It Will Operate*** Documentation of the process (*e.g.*, regular meetings — annual, quarterly or more frequent, if necessary — with formal agendas and minutes that record decision-making) will be the sponsor's most significant proof of its adherence to fiduciary standards.

- ***Measure and Evaluate Investment Performance*** The main objective of performance measurement and evaluation is to provide documentation of the plan sponsor's attention to its fiduciary responsibilities through the ongoing analysis of investment performance against current policies, market opportunities and the plan's future needs. Performance measurement assists plan sponsors in evaluating the evolving characteristics of each investment option. The evaluation normally includes the following (along with the factors analyzed in the overall plan strategy analysis):
  - An overview of economic and general market conditions over relevant time periods,
  - Performance of each option related to established benchmarks,
  - Comment on manager tenure and other fund characteristics,
  - Monitoring fund expense ratios and eligibility for lower share class opportunities,
  - Analyze the extent to which investment policies have been carried out and how they have affected the actual results, and
  - Recommend alternatives for dealing with any of the issues noted above.

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As with all issues involving the interpretation or application of laws and regulations, plan sponsors should rely on their attorneys for authoritative advice on their fiduciary responsibilities. To discuss reviewing DC plan investment options and the steps descried above, contact your Segal Advisors consultant or the nearest Segal Advisors office.

The News in Brief

Final Department of Labor regulations recently issued* under §404(c) of ERISA define three types of programs that qualify as QDIAs:

- A lifecycle or targeted retirement date fund,**
- A professionally managed portfolio that allocates account balances among existing plan options, taking into account the individual's age or retirement date, and
- A balanced fund that takes into account the characteristics of the group as a whole.

Also, a stable-value or capital preservation fund can be a temporary QDIA, to hold participants' money for up to 120 days.

Generally, the intent is to provide a single investment, capable of meeting a participant's investment goals over the long term. Of course, a plan sponsor can select a different default investment option, but in doing so would not receive the benefits of automatic fiduciary protection under ERISA with regard to the default investment.

(To return to the beginning of the *Spotlight*, click here.)

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* These were published in the October 24, 2007 *Federal Register*: http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/07-5147.pdf

** Segal Advisors published a *Segal Advisory* that discussed these funds. See http://www.segaladvisors.com/publications/dec06segaladvisory.pdf

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