

PLAN FUNDING & FIDUCIARY RESPONSIBILITIES

Stuart Hack, JD, CLU
Sunlin Consulting LLP
shack@sunlin.biz
949-770-7322

1. Funded vs. Unfunded

- a. Funded– Assets placed in a trust to fund retirement plan benefits, solely for the benefit of plan participants
- b. Unfunded – Benefits, determined by contract, are “promised” by the employer (in general)

2. Unfunded Plans

- a. Non-qualified Deferred Compensation Plans
 - i. Contractual promise to pay at a future date
 - ii. Subject to risk of employer creditors
 - iii. Benefit amount based on specific criteria
 - iv. Sometimes utilizes shadow investment portfolio
 - v. Requires substantial risk of forfeiture
 - vi. Can accumulate assets in a Rabbi Trust to add some protection to covered employee
 - vii. Only highly compensated employees may be covered
- b. 457(b) Plans for HCE and NHCE; 457 (f) Plans for HCE only
 - i. For certain tax exempt and governmental organizations, only
 - ii. Governmental plans may be funded
 - iii. Can accumulate assets in a Rabbi Trust

3. Funded Plans

- a. All Qualified Plans Must be Funded
- b. Funding Vehicles
 - i. Trust

1. Full Trustee – full fiduciary responsibility, including selection and monitoring plan investments
 2. Directed Trustee – liability limited to specific activities, usually to hold assets, transmit transactions, maintain record of plan assets
 - ii. Custodial Account – similar to Directed Trustee
 - iii. Annuity Contract – insurance contract with underlying assets held by insurance company. Insurance company is the custodian of the assets
- c. Typical Types of Plan Assets
- i. Mutual funds - registered securities
 1. Various share classes, designed for specific product distribution streams
 - a. Brokers
 - b. Insurance agents
 - c. Broker/dealers
 - d. Record keepers
 2. Various asset classes
 - a. Equities
 - i. Foreign
 - ii. Domestic
 - iii. Large cap
 - iv. Small cap
 - v. Medium cap
 - vi. Value
 - vii. Growth
 - viii. Blend
 - ix. Special asset classes, such as Real Estate
 - b. Bonds
 - i. U. S. Treasury
 - ii. Corporate
 - iii. Foreign

- iv. Hi Yield
 - c. Money Market
- 3. Internal fees/charges/expenses
 - a. Disclosed in prospectus
 - i. Investment management fee
 - ii. 12b-1 fee
 - iii. Transfer agency fee
 - iv. Administration and record keeping fee
 - v. Commissions
 - vi. Contingent deferred sales charges
 - b. Undisclosed expenses/costs
 - i. Trading expenses
 - ii. Trading efficiencies/inefficiencies
- ii. Stable asset funds
 - 1. Guaranteed yield usually annually adjusted
 - 2. Market value adjustments usually made if plan terminates the contract and surrenders it.
 - 3. Usually benefit payments exempted from market value adjustment
 - 4. Participant direction sensitive; i.e. no market value adjustments for participant direction into or out of stable value account
 - 5. Usually restrictions applied for transfers out to a “competing” fixed income investment option
 - 6. Underlying assets include bonds, BIC’s, GIC’s, insurance company general accounts
 - 7. Looks and acts like a mutual fund
- iii. Insurance company managed accounts/separate accounts
 - 1. Typically guaranteed accounts
 - 2. Can also be various asset classes, like mutual funds offer
- iv. Annuity wrapped accounts

1. Insurance company wraps services, annuity rate guarantees and fees around the mutual fund or separately managed account
 2. Provides a method for flexible compensation for distribution systems
- v. Separately Managed Accounts
1. Portfolios managed by an independent investment manager
 2. Some mutual fund managers also manage separate accounts
 3. Potential for much lower management fees and avoidance of various expense and sales charges

4. Fiduciary Responsibilities

a. ERISA General Responsibilities

“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...”

b. ERISA Fiduciary Investment Responsibilities

- i. Establishing asset allocations
- ii. Selection, monitoring and replacement of investment managers
- iii. Best practices and case law
 1. Written Investment Policy Statement (IPS)

2. Document periodic monitoring of managers and asset classes and all decisions made by investment committee
- iv. Can be tasked to third parties who have requisite expertise
 1. As ERISA 3(21) co-fiduciary, or
 2. As ERISA 3(28) investment manager fiduciary
 3. Plan sponsor has ultimate responsibility for selecting and reviewing the third party
- c. Defined Benefit Plans
 - i. Investment fiduciary responsibilities
 1. Create asset allocation appropriate for funding guaranteed, pre-determined pension benefits
 2. Maintain appropriate liquidity to pay benefits as they become due
 - ii. Investment gains/losses
 1. Affect amount of employer contributions
 2. Do not affect amount of benefits to participants
- d. Trustee-Directed Defined Contribution Plans
 - i. Investment fiduciary responsibilities
 1. Create asset allocation appropriate for
 - a. Age make-up of covered group of participants
 - b. Providing retirement benefits
 2. Maintain appropriate liquidity to pay benefits as they become due
 - ii. Investment gains/losses
 1. Affect amount of benefit participants have at retirement
 2. Do not affect amount of employer contribution
- e. Participant-Directed Defined Contribution Plans
 - i. Investment fiduciaries responsible for:
 1. Providing investment alternatives with sufficient range of risk for participants to create asset allocations responsive to their risk tolerance and length of their accumulation period

2. Selection and monitoring of investment alternatives provided by the plan
 3. Changing investment managers and investment alternatives, when appropriate to do so
- ii. Investment gains/losses
 1. Affect amount of benefit participants have at retirement
 2. Do not affect amount of employer contribution
 - iii. ERISA 404(c) provides
 1. Fiduciary safe harbor for participant-directed asset allocation investment results
 2. QDIA fiduciary safe harbor for default accounts
 - a. Accounts of participants who fail to provide investment direction must be put into a default account, selected by the plan's investment fiduciary
 - b. QDIA specifies rules for selection of a default investment that qualifies as a safe harbor for the investment fiduciary, i.e. the fiduciary is not responsible for the investment results of the default investment
 - iv. ERISA 404(a)(5)
 1. Effective for plan years beginning after November 1, 2011
 2. Expenses charged against participant accounts must be disclosed to plan participants
 3. Specified investment information must be provided to plan participants
 4. Other specified investment information must be made available when participants request it
 5. Plan sponsor has the responsibility to disclose to plan participants
 - a. May reasonably rely on information provided by service provider(s)
 6. Failure to provide disclosures is a Prohibited Transaction

- f. ERISA Section 408(b)(2) – applies to all types of plans
 - i. Effective for plan years beginning 1-1-12
 - ii. Service providers must disclose to appropriate plan fiduciaries
 - 1. Expenses charged
 - 2. Revenue received
 - 3. Direct and indirect
 - iii. Responsibility of service provider to disclose
 - iv. Responsibility of plan sponsor to make sure disclosures received and reasonableness of accuracy
 - v. Failure to disclose and/or failure obtain disclosures subject to being a Prohibited Transaction
- g. Extent of Liability Exposure
 - i. Each fiduciary is potentially personally liable for any losses caused to plan or participants
 - ii. Potential penalties for Prohibited Transactions

5. Fiduciary Liability Management

- a. Fiduciary failure law suits are EXPENSIVE
 - i. Legal defense costs
 - ii. Company resources diverted from production, sales, etc.
 - iii. Ultimate judgment results
- b. Fiduciary liability insurance only covers defense and settlement
- c. Best insurance is documented fiduciary compliance procedures and activities

6. Employee Plans Compliance Resolution System

- a. Correct qualification problems through Employee Plans Compliance Resolution System (EPCRS)
- b. Revenue Procedure 2008-50.
- c. The components of EPCRS are:
 - i. Self-Correction Program (SCP),
 - ii. Voluntary Correction Program (VCP)

7. U.S. Department of Labor Correction Programs

- a. Correct fiduciary problems through Employee Benefits Security Administration (EBSA)
- b. The components are:
 - i. Delinquent Filer Voluntary Compliance Program (DFVC)
 - 1. Provides plan administrators with a way to comply with the annual reporting requirements by coming up to date with corrected filings of 5500 Forms.
 - ii. Voluntary Fiduciary Correction Program (VFCP)
 - 1. Gives plan sponsors and service providers the opportunity to self-correct fifteen specific financial transactions that violate ERISA, such as delinquent participant contributions.