THE NATIONAL LAW REVIEW

Best Interest and Best Practices #6: What is the Baseline for A Committee to Act in the Best Interest of its Participants? (Part 3)

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Wednesday, October 17, 2018

This is the sixth of a new series of articles titled "The Bests." The series focuses on Best Interest and Best Practices. Those topics give me flexibility to discuss a range of subjects that affect both service providers, including advisors, and plan sponsors, including 401(k) and 403(b) committees.

In my last two posts (Bests #4 and Bests #5), I discuss the NYU case and the "bad" and "good" behavior of committee members. I concluded my last post with the point that process matters. Of course, it was unspoken that I was referring to a good process. This article discusses the fundamentals of a good process and the lessons learned from the NYU decision.

- The NYU committee met quarterly.

There isn't a prescribed timing for fiduciary meetings; the requirement is that plan fiduciaries, usually committee members, meet with the frequency necessary to properly do their job. Some aspects of the job, such as review of investments, may require more frequent meetings . . . at least annually, although quarterly would, under ordinary circumstances, clearly satisfy the requirement. An exception would be if a significant change occurred between meetings, for example, the sale of the mutual fund manager, the resignation of the mutual fund manager (where the fund was managed by a single manager), or other changes that could immediately impact an investment.

On the other hand, the monitoring of service providers may not require the same frequency. Absent extraordinary circumstances, annual reviews should ordinarily satisfy the fiduciary requirement (and, even there, it may not need to be that often). Of course, there are some exceptions for unusual events. One of those would be where an employer is receiving complaints from participants that, if valid, would raise concerns about the quality of the service provider, or the timely delivery of the services.

In any event, quarterly meetings are a reasonably good practice for risk management purposes.

- <u>The committee used an adviser with expertise with similar plans</u>.

There is not a requirement that plan committees use advisers. Instead, it is a best practice. However, if committee members lack the expertise needed to prudently select and monitor a plan's investments and to evaluate their expense ratios (including share classes), the committee members need to obtain that expertise from another source. Needless to say, good risk management dictates that the source be independent of the investments, in the sense that the source of information not be related to the mutual fund management company or to an organization that receives money from the mutual funds.

If an adviser has conflicts of interest, the committee has the added burden of identifying the conflicts and determining whether the participants will be adversely affected by those conflicts. It's beyond the scope of this article to fully discuss the selection of advisers, but a starting point is that, when an adviser is paid directly by the plan or the employer, the potential of conflicts is reduced (and perhaps eliminated). On the other hand, where the adviser is paid from the investments, there is an obvious conflict, in the sense that the adviser is incentivized to recommend mutual funds or other investments that provide higher compensation. That's not to say that all commissioned advisers (or other advisers who receive third party payments) will succumb to the conflicts. However, committee members need to know that they have a legal duty to understand and evaluate conflicts of interest.

- <u>The committee adopted and followed an investment policy statement</u>.

There is not a legal requirement to have an investment policy statement (IPS). However, it is a best practice. A well-prepared IPS will describe the steps to be followed by a committee in evaluating the quality and costs of the investments. In effect, it will walk committee members through the process of investment selection and monitoring. As a part of that, the IPS should have specific criteria for different types of investments. However, at least in my view, an IPS should specifically state that the provisions are "guidelines" for the committee and that the expectation is that the committee will use its judgment and discretion, as opposed to strict adherence to the guidelines. That reflects my view that a qualitative analysis cannot always be defined by numbers and percentages. In fact, the court in the NYU case said the same, when it discussed the difficulty of benchmarking one of the investments.

These are important steps in a prudent process. However, the committee in the NYU case also made some mistakes. Based on the judge's description, some of the committee members were not engaged and did not see themselves as being responsible for making fiduciary decisions. Instead, they viewed themselves as providing information and administrative services to the committee. Those people should not have been on the plan committee. Committee members should understand that they are fiduciaries and owe duties of prudence and loyalty to the participants. There is nothing wrong with having administrative personnel attend the meetings, but there is something wrong with a fiduciary that has a ministerial mindset.

The NYU case covered a number of issues, some of which are not discussed here. However, the discussions in this article, and the preceding two articles, are a primer for plan committee members. Advisers should help them understand the good and the bad of the NYU case.

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