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State of Montana



# Retirement Plan Fiduciaries: Steps to Successful Plan Governance and Legislative/Regulatory Update

Marilyn R. Collister

Senior Director, Legislative and Regulatory Affairs

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# Discussion Topics

- Applicable law
- Identifying plan fiduciaries
- Suggestions throughout for mitigating risk
- Fiduciary standards of conduct
- Plan administration and documents
- Selecting and monitoring:
  - Investments and advisers, and
  - Other service providers
- Use 404(c) to mitigate risk
- Lessons learned from participant lawsuits
- Action items for mitigating risk
- Legislative and regulatory update



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# Fiduciary Responsibility - Applicable Law

- Governmental plans are governed by state law and the Internal Revenue Code
- Montana Uniform Prudent Investor Act - MT Code Annotated § 72-38-901, et seq.
  - 72-38-901 Prudent investor rule
  - 72-38-902 Standard of care -- investments and management -- considerations
  - 72-38-903 Diversification -- duty of trustee -- exception
  - 72-38-904 Review of assets -- time for compliance
  - 72-38-905 Compliance determinations -- standards
  - 72-38-906 Interpretation of trust terms construing legal investments
- Code Sec. 457(g)'s trust requirement imposes the exclusive benefit rule and prudence requirements on governmental plan fiduciaries.
- Additionally, most governmental plans use Employee Retirement Income Security Act of 1974 (ERISA) rules as a guide.

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# Identify Your Plan Fiduciaries

- Fiduciary status applies based on functions performed, not a person's title.
- Fiduciaries held to the highest standards under the law.
- Your fiduciaries include:
  - Board members making decisions about operating the plan and managing plan assets,
  - Anyone providing investment advice for a fee, and
  - Anyone else who has the authority to exercise discretion over plan administration or plan assets.
- Staff members and third parties, such as attorneys and recordkeepers, who only perform ministerial duties are generally not fiduciaries.
- Train your fiduciaries on basic duties and standards of care and following plan documents.
- We will look at suggestions for mitigating risk throughout the presentation.

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# Board Meetings: Mitigating Risk

- Understand fiduciary duties:
  - Board members, and other plan fiduciaries must understand their responsibilities.
  - Fiduciaries should attend periodic fiduciary training that includes a review of fiduciary duties, plan documents, plan administration and the plan's investment options.
- Board meetings:
  - Receive and review materials from investment advisors and administrators ahead of the meetings and ensure you understand them.
  - Meet regularly and actively engage with each other, the materials, the investment advisors, service providers, outside counsel, the administrative staff.
  - Be prepared to discuss materials prepared by investment advisors and ask questions about investments and strategy.
  - Review the fees and performance of the investment options at every meeting.
  - Review the advisors' recommendations and the available information, and request more information if needed for a decision.

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# Board Meetings: Mitigating Risk

- Board meetings continued:
  - Act independently – do not just rubber stamp advisor’s recommendations.
  - Ask about options to reduce fees (e.g. other share classes, separate accounts or collective trusts).
  - Monitor the investment consultant and review the consultant’s performance.
  - Periodically review the performance of the recordkeeper and other service providers.
  - Routinely review the fees being paid to service providers to ensure they are reasonable.
  - Consider the day to day operations of the plan paying particular attention to provisions unique to 457(b) plans.
- Know the documents governing plan administration:
  - Key plan documents include the plan document, trust agreement, the Investment Policy Statement (“IPS”), and vendor agreements.
  - Periodically review these documents for consistency and update as applicable.
  - Review plan administrative changes and amendments.

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# Fiduciary Standards of Conducts

- Retirement plan Boards should understand the basic responsibilities of a plan fiduciary as required by state law.
  - Being prudent requires prudent processes,
  - Exercising loyalty and impartiality – avoid conflicts of interest,
  - Offering diverse range of investments,
  - Monitoring and supervising investments and service providers, and
  - Ensuring plan expenses and fees are reasonable.

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# Duties of Loyalty, Prudence and Document Compliance

- Duty of loyalty a/k/a the exclusive benefit rule:
  - Act solely in the best interests of the plan participants,
  - Act for exclusive purpose of providing plan benefits, and
  - Ensure plan fees and expenses are “reasonable.”
  - Cannot put employer interests before those of plan and participants.
  - Avoid conflicts of interest.
- Duty of prudence:
  - Must exercise reasonable care, skill, and caution.
  - Act with the diligence and good judgment a knowledgeable person administering a retirement plan would use.
  - Prudence comes into play in every fiduciary activity.
  - Focus is on following sound processes when making fiduciary decisions.
- Duty to follow plan document:
  - Document must comply with Internal Revenue Code and regs.
  - It is your contract with plan participants and your manual for administering the plan.



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# Duty to Prudently Select/Monitor Plan Investments

- State law requires fiduciaries to adopt prudent investment policies for selecting and monitoring plan investments - your IPS defines your processes for investment decisions.
- Monitoring is required to meet the courts' requirement to exercise reasonable diligence in disposing of funds which are improper to keep.
- U.S. Supreme Court unanimous opinion on May 18, 2015 in *Tibble v. Edison* - fiduciaries have "a continuing duty – separate and apart from the duty to exercise prudence in selecting trust investments at the outset – to monitor, and remove imprudent investments."
- The court emphasized that the role of a fiduciary is active, not passive, with an ongoing duty to monitor.
- Retaining consultants to assist you in the selection, monitoring and deselection of investments and monitoring the associated fees is one way to mitigate risk.

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# Duty to Prudently Monitor Investment Advisers

- Plan sponsor recommendations from a Broker/Dealer (DB) or Registered Investment Advisor (RIA) are not impacted by the new SEC rules.
- Certain plan participant advice, however, is covered by the new SEC rules, including advice on:
  - rollovers,
  - investment allocations and
  - distributions.
- If you have participant advice built into your plan, you should mitigate your risk by:
  - Requesting the advice provider comply with the new regulations.
  - Determining if the advice provider appears to be taking proper action.
  - Documenting this process in your fiduciary files.

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# Duty to Prudently Monitor Service Providers

- Plan fiduciaries have the ultimate responsibility to prudently select and oversee the plan's outside service providers and their fees and how those fees are paid.
- Service providers may include the:
  - recordkeeper,
  - investment consultant,
  - trustee,
  - outside counsel,
  - auditors, and others.
- Mitigate your risk by monitoring the performance of these entities, the types of services they provide, and, importantly, their fees and how those fees are paid.
- Ensure each provider is properly performing the services they agreed to in the services' agreement.
- Periodically audit the provider's performance and follow up on any participant complaints, etc.

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# Follow ERISA 404(c) to Mitigate Risk

- An effective participant communications program is more than just compliance with specific fiduciary or regulatory requirements.
- Effective communications ensure all employees know how the plans works.
- Prior to enrollment, employees should understand the plan provisions restricting access to their funds.
- Once enrolled, participant communications and seminars should provide educational opportunities to allow participants to make informed decisions.
- Your 457(b) is designed to delegate control to participants to make their own investment decisions.
- Compliance with ERISA 404(c) can relieve plan fiduciaries of liability for participant's investment decisions.

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# Follow ERISA 404(c) to Mitigate Risk

- 404(c) is essentially a communications compliance statute.
- Fiduciaries are required to provide information to participants and beneficiaries that:
  - Allows them to make informed investment decisions,
  - Describes the fees/expenses paid by the plan and participants, and
  - Describes any restrictions on participants' ability to exercise control over their accounts.
- Review your communication pieces periodically to ensure that they are easy to understand and are up to date. Revise as necessary.
- Retain copies of recent communication materials to document compliance.



# Lessons from Lawsuits

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# Lawsuits Began Over a Decade Ago

- In September 2006, the initial wave of “excessive fee” lawsuits was filed against fiduciaries of large defined contribution retirement plans across the country.
- Cases allege that plan fiduciaries:
  - Did not prudently select and monitor plan investments and retained imprudent, poorly performing investment options in the plans;
  - Offered retail class investment options when identical, less expensive institutional class options were available;
  - Allowed uncapped administrative fees to be collected through revenue sharing;
  - Did not properly monitor compensation arrangements and did not properly disclose fees;
  - Offered too many funds or used multiple recordkeepers,
  - Allowed service providers to use plan data to sell outside proprietary products; and
  - Did not guard against conflicts of interest.

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# Lawsuits Began Over a Decade Ago

- Actions prompting the lawsuits are not unique to the employers being sued:
  - Many other plan sponsors are “guilty” of the same actions (or inactions).
  - Most of the cases are NOT the result of fraudulent activity.
- Court decisions are very instructional.
- Cases have turned on:
  - Fiduciary prudence and
  - Operating the plan in compliance with plan documents.
- Courts that have ruled that plan fiduciaries breached their fiduciary responsibilities found the retirement plan Board/Committee lacked a disciplined process for administering the plan.



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# Action Items for Mitigating Risk

- Your processes are key - be prepared to demonstrate you followed a prudent process and made prudent decisions when selecting investments.
- Read your plan document; understand how each provision works.
- Review plan policies, procedures, and forms for compliance with plan terms.
- Perform a self-examination of the plan concentrating on the top IRS audit issues.
- Audit administrative tasks outsourced to each service provider.
- Provide participants with information to make informed investment decisions so you are not responsible for they choices.
- Remember, if you make every plan decision solely in the best interests of plan participants - everything else is common sense.
- Document your decisions – the minutes should reflect the prudent processes you used when selecting or replacing investments and reviewing fees.



# Legislative Update

SECURE Act

Retirement and Savings Act (RSSA)

Social Security Fairness Act of 2019

The Equal Treatment of Public Servants Act of 2019

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# SECURE Act

- The Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019 passed by the full House of Representatives on May 23, 2019 by a vote of 417- 3 but is stalled in the Senate.
- If it becomes law this year, the provisions will generally be effective for plan years beginning after December 31, 2019.
- Lifetime Income Option provisions:
  - If a plan’s lifetime income option is eliminated, participants in a 401(k), 403(b) and 457(b) could do a direct rollover to an IRA or another plan with such an option.
  - At least annually, plan would be required to project participant’s accrued account balance to an annuity payout at retirement.
  - DOL to provide guidance on permissible assumptions to be used in calculating the lifetime income projection.
- Establish safe harbor for plan fiduciaries selecting an annuity provider.

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# SECURE Act

- Eliminate life expectancy payouts for beneficiaries – full payout in ten years of the death of the participant.
- Exceptions to the 10 year rule, include:
  - Surviving spouse
  - Minor child
  - Disabled or chronically ill beneficiaries
  - Any person not more than 10 years younger than the IRA holder
- Provide for penalty free withdrawals for birth or adoption of a child:
  - Exempt from 10% early withdrawal penalty
  - Exempt from mandatory 20% withholding
  - Limited to \$5,000 per birth or adoption
  - Could be repaid without regard to 60 day limit on rollovers
- Would allow contributions to traditional IRAs after age 70 ½.
- Increase required beginning age for required minimum distributions to 72.

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# Retirement Security and Savings Act (RSSA)

- The Retirement Security and Savings Act (RSSA) introduced by Senators Rob Portman (R-OH) and Ben Cardin (D-MD).
- Hoping the bill can receive consideration by end of year.
- Many NAGDCA legislative priorities (marked by an \*) are included in RSSA:
  - Eliminate the “first day of the month” rule for 457(b) plans – allowing deferral changes at any time subject to payroll restraints, just like 401(k) and 403(b).\*
  - Allow non-spousal beneficiaries of inherited IRA assets to roll these assets into their own employer-sponsored DC plans so participants to better coordinate their retirement savings and take advantage of the generally lower fees and administrative costs in DC plans.\*

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# Retirement Security and Savings Act (RSSA)

- NAGDCA legislative priorities (marked by an \*) in RSSA Continued:
  - Allow Roth IRAs to be rolled into Roth DC plan accounts instead of only to other Roth IRAs.\*
  - Exempt plan Roth accounts from the required minimum distribution (RMD) rules, just like the current rule for Roth IRAs. No RMDs would be required until after the participant's death.\*
  - Permit 457(b), 401(a), 401(k), and 403(b) plan participants to make tax-free qualifying charitable distributions (QCDs) of up to \$100,000 per year, including RMDs.\*
    - Currently only available from traditional IRAs accounts.
    - Would eliminate need to roll money from a plan account to an IRA prior to age 70 ½.
- Allow 403(b) plans to use collective investment trusts.\*
  - Would provide public school employees with access to same lower cost investment vehicles available to 401(k) and 457(b) plans.

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# Retirement Security and Savings Act of 2019

- Other RSSA provisions that would impact governmental plans or participants:
  - Allowing in-service withdrawals from 457(b) plans at age of 59 ½, rather than age of 70 ½.
  - Allowing severance pay to be contributed to a 401(k), 403(b), and 457(b) plan.
  - Updating of mortality tables for minimum required distributions.
  - Higher catch-up limit to apply at age 60 – \$10,000, instead of \$6,000 age 50 limit.
  - Allow non-spouse beneficiaries to do 60-day rollover to inherited IRA.

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# The Social Security Fairness Act of 2019 (H.R. 141)

- Introduced by Rep. Rodney Davis [R-IL-13] on January 3, 2019.
- Bill is bipartisan; 192 co-sponsors – referred to House Ways and Means Committee.
- H.R. 141 would amend title II of the Social Security Act to repeal;
  - the Windfall Elimination Provision (WEP) and
  - the Government Pension Offset (GPO) titles of the Social Security Act.
- The WEP reduces the earned Social Security benefits of a person who also receives a public pension from a job not covered by Social Security.
- The GPO impacts the spousal benefits of federal, state or local government employees if their job isn't covered by Social Security.
- If passed this year, amendments shall apply with respect to monthly insurance benefits payable under title II of the Social Security Act for months after December 2019.



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# The Equal Treatment of Public Servants Act of 2019 (H.R. 3934)

- Introduced by Rep. Kevin Brady [R-TX] on July 24, 2019.
- A number of bipartisan co-sponsors.
- Amends title II of the Social Security Act to permanently repeal the windfall elimination provision (WEP) and replace it with a formula equalizing benefits for certain individuals with non-covered employment.
- Those with noncovered earnings and a noncovered pension first eligible for benefits:
  - from 2022 to 2060 (age 59 to 21 in 2019), the higher of current law or the proportionate formula, and
  - in 2061 (age 20 and younger in 2019), the proportionate formula.
- The rebate is a flat monthly payment of \$100/month for workers and \$50/month for spouses and children.
- SSA must include noncovered earnings in SS statements to allow individuals to verify the accuracy of the agency's earning record.



# Regulatory Update

SEC Investment Advice Rules Impacting  
Plan Participants

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# SEC Investment Advice Rules Impacting Plan Participants

- Regulation Best Interest (Reg BI): A “fiduciary-like” standard for governing broker/dealer and representatives conduct:
  - new standard of conduct for broker-dealers
  - when making a recommendation to a retail customer
  - of any securities transaction or investment strategy involving securities
  - including retirement plan rollover recommendations.
- “Retail customer” includes retirement plan participants and IRA owners.
- Brokers, dealers, and representatives who are natural persons must:
  - comply with Reg BI when they make “recommendations” to plan participants and IRA owners
  - regarding the purchase, sale or exchange of any security or any investment strategy involving securities.

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# SEC Investment Advice Rules Impacting Plan Participants

- Examples of “recommendations” for purposes of triggering Reg BI:
  - Recommendations of a securities transaction, including distribution recommendations from an employer’s plan;
  - Implicit hold recommendation if a broker agrees to monitor a customer’s account and makes no subsequent recommendation to buy or sell a security; and
  - “Account recommendations” which the preamble states include recommendations to roll over or transfer assets from one type of account to another (e.g., employer retirement plan to an IRA).
- Reg BI’s “General Obligation,” requires broker-dealers to act in the best interest of plan participants at the time the recommendation is made.
- Broker-dealers cannot place their financial or other interest ahead of the interest of the participant.

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# SEC Investment Advice Rules Impacting Plan Participants

- Disclosure Obligation.
- Broker-dealers, prior to or at the time of the recommendation, must provide the plan participant, in writing, full and fair disclosure of:
  - The scope and terms of the relationship, including the material fees and costs that apply to the participant's transactions, holdings, and accounts;
  - Material limitations on the securities or strategies that may be recommended including, for example, that the broker-dealer may only be able to recommend proprietary products; and
  - All material facts relating to conflicts of interest associated with the recommendation.

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# SEC Investment Advice Rules Impacting Plan Participants

- Care Obligation.
- Broker-dealers, in making the recommendation, must exercise reasonable diligence, care, and skill and must have a reasonable basis that a recommendation is in the best interest of:
  - Plan participants generally,
  - At least some plan participants,
  - That a series of recommended transactions, not just each recommendation to a participant, is not excessive (e.g., churning) and is in the participant's best interest.
  - That specific participant recommendations are based on that participant's investment profile and the potential risks, rewards, and costs associated with the recommendation.
- Broker-dealers must never place their financial or other interest ahead of the interest of participants.

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# SEC Rules Applicable to Rollovers

- Reg BI is a higher standard for rollovers than existing "suitability" standard for brokers.
- The new rules encompass three elements of a rollover recommendation to:
  - take money out of a plan (i.e., it's not in a participant's best interest to be in the plan);
  - put that money in an IRA (i.e., the IRA is the best place to put the money);
  - invest the money (i.e., investment choice).
- SEC rules apply to rollover and account opening advice *even in the absence of specific securities recommendations*.
- "Best interest" standard of care, all of the disclosure obligations, and the conflict prevention and mitigation obligations apply to recommendations made by a representative of a broker to open an IRA or to roll money over to an IRA.

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# New SEC Rules Applicable to Plan Rollovers

- Broker must do a comparative analysis between a client's plan and an IRA based on several factors, including:
  - fees and expenses;
  - level of service available;
  - available investment options;
  - ability to take penalty-free withdrawals;
  - application of required minimum distributions;
  - protection from creditors and legal judgments;
  - holdings of employer stock; and
  - any "special features" of the existing account.
- SEC says this list isn't exhaustive and some factors may have more or less relevance given the particular client.



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# SEC Rules Applicable to Rollovers

- Broker-dealers can't rely on an IRA having more investment options than an employer's plan as "the basis for recommending a rollover."
- In addition to the number of investment options, other requirements apply, such as:
  - Consideration of a participant's investment profile, and
  - The potential risks, rewards and costs of a particular security or investment strategy.
- SEC says cost is a "fairly significant factor" in assessing such recommendations, because IRAs are almost always more expensive employer plans.



Thank you!

Questions?



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