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Introduction

Employee Retirement Income Security Act (ERISA) fiduciaries face challenging tasks: They must familiarize themselves with ERISA’s complicated rules of fiduciary conduct. They must understand and evaluate the performance of plan investments, and in doing so, they are subject to ERISA’s prudent expert and exclusive purpose standards. In this handbook we focus on defined contribution (DC) plan investment fiduciaries and some of the key issues they face.

ERISA Fiduciary Basics

ERISA establishes rules for how an employer-sponsored retirement plan should be managed. It includes rules for administration, consideration of participant claims, and the management of plan investments—the latter being the focus of this handbook.

Who Is an ERISA Fiduciary?

A fiduciary is a person who: (1) exercises control over plan administration or plan assets, (2) renders investment advice for a fee, or (3) has any discretionary authority or responsibility with respect to plan administration. Under ERISA, investment responsibility is generally delegated to a “named fiduciary.” Typically, this is a committee of sponsor officials.

ERISA’s General Fiduciary Standards

ERISA includes some general rules about how a fiduciary must act that describe the basis upon which fiduciary decisions must be made. Fiduciaries must:

- Act exclusively for the purpose of providing benefits and paying plan expenses.
- Act with care, skill, prudence, and diligence. The ERISA prudence standard has generally been characterized as a “prudent expert” standard.
- Diversify plan investments to minimize the risk of large losses.
- Act in accordance with plan documents to the extent they are consistent with ERISA.

Prudent Expert

ERISA section 404(a)(1)(B) requires that a fiduciary of a DC plan must act “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.”
**ERISA Section 404(c)**

In most 401(k) or other ERISA-governed, participant-directed DC plans, the fiduciary establishes a fund menu from which the participants choose investments. Provided certain requirements are met, under ERISA section 404(c) the fiduciary is not responsible for losses that result from those choices (e.g., if a participant invests 100% in an equity fund and the stock market loses money). In this handbook we generally assume that the plan uses a fund menu/participant choice structure and complies with the requirements of ERISA section 404(c).

To qualify for ERISA section 404(c) treatment, a plan must generally provide a broad group of investment choices (at least three funds with meaningfully different risk/return profiles); participants must be able to move assets between investment funds at least quarterly (and more frequently if the volatility of the investment warrants it); and participants must be given sufficient information to make an informed choice among the investments (a summary of each fund’s risk/return characteristics and certain fee information; for mutual funds a prospectus upon the participant’s first investment in the fund). Participants must also be notified that the plan is a 404(c) plan.

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**2016 Advice Fiduciary Rule**

In April 2016, the Department of Labor finalized regulations defining who is an “Advice Fiduciary.” Under the new rules, a person is generally an investment Advice Fiduciary if she makes a recommendation to a plan, plan fiduciary, participant, or IRA owner about an investment, rollover, distribution, or investment management (e.g., portfolio composition), and either:

1. She acknowledges that she is a fiduciary
2. The advice is pursuant to an “understanding” that it is based on the recipient’s particular needs or
3. She directs advice about a particular investment to a specific recipient

The Department of Labor has indicated that the plan sponsor generally would not be considered to be an Advice Fiduciary because it generally does not receive compensation. Sponsor employees who are compensated (in part) to advise participants about plan asset allocation or distributions may, however, be considered fiduciaries under the new rule.

ERISA fiduciaries are generally subject to duties of loyalty and prudence; they are generally subject to ERISA’s prohibited transaction rules; and in certain circumstances they may have co-fiduciary liability (liability for the fiduciary breaches of other fiduciaries).
Key Functions of a DC Plan Fiduciary

In managing DC plan investments, fiduciaries should consider eight key areas:

1. Evaluate and Update the Investment Structure
2. Apply and Periodically Review the Investment Policy Statement
3. Evaluate and Monitor the Target Date Fund Glide Path as part of Qualified Default Investment Alternative (QDIA) Oversight
4. Review and Monitor Investment Manager Performance
5. Monitor and Benchmark Plan Fees
6. Oversee Required Employee Communications
7. Review Overall Plan Utilization
8. Review Defined Contribution Trends and Overall Plan Effectiveness

We describe each of these areas in detail in the following sections.
1. Evaluate and Update the Investment Structure

While participants in a 404(c) plan are generally responsible for choosing funds from the investment menu, the fiduciary must make some basic decisions about the available investments, including:

- What asset classes and investment styles (active, passive, etc.) will be available
- Whether to provide a default fund (e.g., a target date fund) and, if so, its design
- Whether to provide a brokerage window

Per ERISA section 404(c), the investment structure of an employee-directed DC plan should offer participants an array of investment options that provide them with the ability to construct a diversified portfolio appropriate to the individual’s time horizon and risk tolerance. Beyond that, basic philosophical tenets to keep in mind when developing the investment structure include:

**Build for the long term.** An investment structure should reflect legal and regulatory trends, product innovation, and adherence to a three-tiered framework (see the exhibit below) that facilitates plan usage for everyone, from “do-it-for-me” to “do-it-yourself” types of participants.

**Simpler can be better.** The number and composition of choices affects participants’ allocation decisions. The optimal number of investments offers sufficient diversification opportunity while minimizing participant confusion. The menu should also avoid creating unintended biases. For example, if there are a lot of small cap equity options, the sheer number could cause participants to overweight this asset class.

**Offer appropriate core options.** They should provide access to capitalization and style spectrums. A plan participant’s ability to construct a diversified portfolio depends on access to core investment options representing major asset classes. The primary building blocks of well-diversified portfolios include: capital preservation, fixed income, U.S. equity, and non-U.S. equity.

**Cost is important.** Investment structures should seek to minimize cost via an effective use of investment vehicles or share classes.

**Sample Three-Tiered Structure**

The three-tiered framework seeks to address the varied needs of different employees. Generally the tiers reflect asset allocation options for the “do-it-for-me” types, core asset classes for “do-it-yourselfers,” and specialty options (e.g., self-directed brokerage window) for more financially-savvy investors.

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<thead>
<tr>
<th>Tier I Asset Allocation</th>
<th>Tier II Core Options</th>
<th>Tier III Specialty Options</th>
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<td>Asset Allocation Funds</td>
<td>Capital Preservation</td>
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<tr>
<td>Target Risk or Target Date</td>
<td>Fixed Income</td>
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<td>Small/Mid Cap Equity</td>
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Fiduciaries should periodically review the plan’s investment structure as part of their regular due diligence process. This might involve ensuring the fund lineup continues to fit plan demographics and needs; identifying opportunities to streamline available investment options; identifying overlaps and gaps in the fund lineup; and adding diversification opportunities. Because of the evolving nature of the DC landscape, fiduciaries need not worry about finding the one “right” overall strategy but should periodically revisit past decisions to determine whether they are still appropriate.

Company objectives, participant preferences, and best practices all change over time. “More is better” used to be the accepted mantra, and many sponsors set up plans with multiple funds in the same asset class. That approach has generally given way to a “less is more” approach. The emerging best practice is to focus on multi-manager funds as the “core” investment strategy.

**Action Items**

- Assess updates on DC practices, regulation, litigation: To understand current trends in investment structures
- Review plan qualified default investment alternative: To determine if it continues to meet the needs of the plan
- Review plan investment options and fees: To meet due diligence requirements
- Recordkeeper/Trust & Custody plan report review: To understand participant utilization of plan investment options
2. Apply and Periodically Review the IPS

Although it is not required under ERISA, Callan recommends the plan’s investment committee adopt an investment policy statement (IPS). The IPS should reflect the plan sponsor’s basic decisions about overall strategy and set basic guidelines for how the plan sponsor designs the fund menu and selects, monitors, and replaces managers.

The biggest risk of an IPS is that it will over-commit plan fiduciaries. We often find that sponsor-fiduciaries have adopted an IPS that includes unrealistic and overly detailed procedures. Plan sponsors should regularly review their IPS (e.g., annually) to make sure that it is flexible, manageable, and continues to reflect committee practice.

Why Should You Have an IPS?

An IPS can provide the plan’s investment committee with a roadmap for making reasonable decisions that focus on the long term. Process is critical. The investment committee should agree on basic objectives for the plan and the fund and then hire managers to achieve those objectives. It is essential to agree on how to measure overall plan and fund manager success, and compare actual outcomes against those objectives. It is critical to undertake this review regularly; otherwise the IPS may become a one-time exercise in wishful thinking that is only revisited when something goes drastically wrong (e.g., a lawsuit). Finally, when a problem arises, the committee should stick to the process: understand what went wrong, develop a strategy to fix it, and execute.
Investment Policy Statement Do’s and Don’ts

**Do**

*Stay on point.* The IPS should set basic guidelines/procedures for selecting, monitoring, and de-selecting funds. Stick to those issues.

*Be clear.* Confusing rules generate confusing results. Plain language and clear metrics are best. Review the IPS with committee members to make sure everyone understands it.

*Develop specific criteria for evaluating results.* The committee will need a reasonable and understandable process for evaluating manager performance. Agree on those criteria in advance and use them regularly to determine what's working and what's not.

*Document decisions.* Committee minutes that explain the decision-making process are essential, particularly if litigation surrounding the committee's decisions should arise.

*Follow the IPS process.* Under ERISA, process is your friend. Your goal is to demonstrate a reasonable process for each decision. A flexible IPS can help prevent committee members from breaking IPS protocol and getting into trouble. Once the substance of the IPS is agreed on, committee members should follow it.

**Don’t**

*Get too detailed.* An overly specific IPS will get in your way. Don’t provide elaborate rules about what kind of minutes will be kept, or make your standards for selecting a new fund or de-selecting an old one rigid. Different situations (e.g., bad performance vs. a change in strategy) will call for different approaches.

*Overcommit.* Plans are not required to have an IPS. If one exists, a court may insist fiduciaries follow it. Keep your process reasonable.

*Focus on the short term.* Markets have cycles, and not every fad is a trend. Discipline and consistency are as important as short-term results, for fund managers and the committee. The committee should generally be focused on strategy, not tactics.

*Set it and forget it.* Committees are dynamic—the IPS should be too. If you change the committee structure, or the committee’s responsibilities change in a way that affects the IPS, you should update the IPS accordingly.

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**Action Items**

- Review the investment policy statement: To perform regular due diligence
- Undertake fiduciary training: To ensure the plan’s investment objectives and key governance procedures are documented as desired
3. QDIA Oversight: Evaluate and Monitor the Target Date Fund Glide Path

Plans typically designate one default fund in which to invest participant contributions if the participant fails to make an affirmative election. Generally, this fund should be a qualified default investment alternative (QDIA). Per the 2006 Pension Protection Act (PPA), a QDIA can be an individually managed account, a balanced fund, or a target date fund (TDF) that meets certain criteria.

As defined by the Department of Labor, a target date fund that would be suitable as a QDIA is:

An investment fund product or model portfolio that applies generally accepted investment theories, is diversified so as to minimize the risk of large losses, and is designed to provide varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures based on the participant's age, target retirement date (such as normal retirement age under the plan), or life expectancy.

— Department of Labor

The most common default funds are TDFs (also known as target maturity funds or lifecycle funds). TDFs generally provide a suite of pre-mixed portfolios, each targeting a specific investment horizon. For example, a set of TDFs might include 10 vintages of funds in five-year increments ranging from a 2015 retirement date to a 2060 retirement date. The funds’ asset allocations change as the target cohort gets closer to retirement, usually increasing fixed income and decreasing equity allocations.

Evaluating Target Date Funds

While TDFs are simple for participants to invest in, they are more complex for plan sponsors to evaluate than single asset-class funds. TDFs have many moving pieces, such as:

- Equity roll down: the rate at which investments of a particular age cohort (say, those retiring within five years of 2020) are shifted from higher-risk (equity) to lower-risk (fixed income) investments
- Glide path asset allocation: diversification and risk over time
- Underlying manager performance: the value-add provided by the underlying managers relative to the passively implemented glide path
- Fees: the underlying managers’ weighted average fees and any glide path management fees

Plan sponsors are increasingly using sophisticated analytics, such as retirement income adequacy analysis, to assess the efficacy of the TDF for their plan. They are also referencing the Department of Labor’s “Tips for ERISA Plan Fiduciaries” (on the following page) in selecting and evaluating their TDFs.
It should also be noted that clearly communicating relevant information about the TDF to participants is important. For example, participants should know the fund's high-level investment strategy, possible risks, and fees.

The Department of Labor’s “Target Date Retirement Funds: Tips for ERISA Plan Fiduciaries” provides general guidance “to assist plan fiduciaries in selecting and monitoring TDFs and other investment options in 401(k) and similar participant-directed individual account plans,” including:

- Establish a process for comparing and selecting TDFs that involves consideration of how well the TDF’s characteristics align with eligible employees’ ages and likely retirement as well as other characteristics of the participant population.
- Establish a process for the periodic review of selected TDFs—at a minimum examining whether there have been any significant changes.
- Understand the fund’s investments—the allocation in different asset classes (stocks, bonds, cash), individual investments, and how these will change over time.
- Review the fund’s fees and investment expenses.
- Inquire about whether a custom or non-proprietary target date fund would be a better fit for your plan.
- Develop effective employee communications.
- Take advantage of available sources of information to evaluate the TDF and recommendations you received regarding the TDF selection.
- Document the process.

Source: Department of Labor 2013 Bulletin “Target Date Retirement Funds: Tips for ERISA Plan Fiduciaries”

Action Items
- Review plan QDIA: To ensure that it meets plan needs
- Recordkeeper/Trust & Custody plan report review: To determine utilization of QDIA
- Manager presentation (as needed): For update on QDIA approach
4. Review and Monitor Investment Manager Performance

Plan fiduciaries are responsible for the overall prudence of the fund’s menu and managers. Adopting a good, workable process is essential to maintaining sound plan investments. This process should be based on the basic building blocks of the IPS. In reviewing the performance of a given fund, plan sponsors should:

– Determine whether the fund or manager continues to fit the asset class for which it was selected.
– Consider the performance of the fund or fund manager against a designated benchmark.
– Understand any changes to people, process, or philosophy.
– Review the fees charged by the fund or fund manager.

Fiduciaries should regularly review fund performance; they should also thoroughly document the review and monitoring process.

Company stock and brokerage windows present unique challenges when it comes to performance. We cover these topics in greater detail in Appendix II.

Mapping Funds

In the event the fund lineup changes or plans merge, the plan sponsor may be required to map participant assets between funds.

Fund-to-Fund Mapping

Fortunately, the PPA provides a safe harbor that allows for ERISA section 404(c) protection when participant assets are reallocated (“mapped”) to remaining or new funds if certain requirements are met:

– Participants’ accounts must be reallocated among one or more remaining or new investment options, “the stated characteristics of [which], including characteristics relating to risk and rate of return, are, as of immediately after the change, reasonably similar to those of the existing investment options as of immediately before the change.”
– At least 30 days and no more than 60 days prior to the effective date of the change, the plan administrator must notify participants of the change. The notice must include information comparing existing and new investment options and an explanation that, absent affirmative instructions, participants’ accounts will be automatically reallocated.
– The participant’s investments immediately prior to the “mapping” transaction must have been the product of an affirmative election.
– The participant must not have affirmatively elected to be in a different fund than the one being mapped to.
**Mapping to the QDIA**

A fiduciary may alternatively map fund assets by following the rules that apply to QDIAs (covered in section No. 3 on pages 8 and 9). Again, transferring "non-elected" money to the QDIA may be protected under ERISA section 404(c) under the PPA. Per the Department of Labor: “Whenever a participant or beneficiary has the opportunity to direct the investment of assets in his or her account, but does not direct the investment of such assets, plan fiduciaries may avail themselves of the relief provided by [the final QDIA] regulation, so long as all of its conditions have been satisfied.” Those conditions are:

- The assets must be invested in a QDIA.
- The participant must have been given an opportunity to provide investment direction, but did not do so.
- A notice generally must be furnished in advance of the first investment in the QDIA and annually thereafter.
- Material, such as investment prospectuses, provided to the plan for the QDIA must be furnished to participants.
- Participants must have the opportunity to direct investments out of a QDIA just as frequently as from other plan investments, but at least quarterly.
- The plan must offer a “broad range of investment alternatives” as defined in ERISA section 404(c).

**The Importance of Process**

Mapping and defaults are important tools to use in managing fund changes. There is always a risk of disappointed expectations (e.g., when a participant affirmatively elects to invest in a fund that is then eliminated). The problem becomes especially acute if the “old” fund does well and the “new” one does not after the change. Fiduciaries should thoroughly document compliance with the requirements for mapping and defaults and should make every effort to ensure that participants understand the process and the consequences of not making an affirmative election.

**Action Items**

- Review investment markets: To understand the current environment
- Review investment performance: To highlight recent notable developments
- Review watch list (as applicable): Run prescribed process for investments that warrant extra scrutiny
5. Monitor and Benchmark Plan Fees

Under ERISA, sponsors must ensure that plan fees are reasonable and avoid conflicts of interest. Further, with the issuance of ERISA section 408(b)(2) regulations in 2012, the Department of Labor raised the bar for plan sponsors by requiring them to obtain certain fee information from service providers.

With 408(b)(2), plan sponsors are responsible for ensuring that all covered service providers have supplied the required disclosures, and that such disclosure are complete. It is prudent to regularly compare provider fees with that of competitors and document that process. If the plan sponsor selects a provider with higher fees, the plan sponsor should document the reason that motivated the choice. In summary, fiduciaries’ three critical responsibilities around 408(b)(2) disclosures are to:

1. Determine if the providers have given them all the information they are required to.
2. Understand this information and ask for clarification as needed.
3. Use this information to review the reasonableness of fees and benchmark them annually.

Recordkeeper and Trustee Fees

ERISA requires that fees for recordkeeping and trust services be reasonable. In general, reasonability requires that the fiduciary review the market and pay a competitive rate. The definition of a competitive rate and how it should be paid (per capita, on a plan-wide basis, or as a percent of assets under management) is still in dispute, with little insight provided by the Department of Labor. Field Assistance Bulletin 2003-3 (described below) only notes that fiduciaries must be prudent in selecting the method of fee allocation.

Department of Labor Field Assistance Bulletin 2003-3

- ERISA does not specifically address how plan expenses may be allocated among participants and beneficiaries.
- A fiduciary must be prudent in the selection of the method of allocation.
- The fiduciary weighs the competing interests of various classes of the plan’s participants and the effects of various allocation methods on those interests.
- A fiduciary’s decision must satisfy the “solely in the interest of participants” standard. However, a method of allocating expenses would not fail this standard merely because the selected method disfavors one class of participants, provided that a rational basis exists for the selected method.
Investment Management Fees

Reviewing and benchmarking investment management fees is challenging because there are countless styles and strategies of investments. Certain funds/asset classes are more “commodity like” (e.g., S&P 500 Index fund), and a reasonable fee can be more clearly identified. For other investments, it may be more feasible to establish a reasonable range of fees and to note that other criteria—like performance—are relevant in fund evaluation.

Recent litigation has highlighted the issue of using a higher-priced fund when there is an “identical lower-cost investment” available.

In Tibble v. Edison, the lower court found a fiduciary violated ERISA by selecting a retail mutual fund share class instead of an institutional share class that “offered the exact same investment at a lower fee.” In the cases decided thus far, courts have accepted the argument that selecting a retail share class (higher-priced) when an institutional share class (lower-priced) is available presents an issue under ERISA.

Implications of Tibble v. Edison

On May 18, 2015, the United States Supreme Court reversed the Ninth Circuit Court of Appeals’ ruling that the 401(k) fee lawsuit of Tibble v. Edison was time-barred, remanding the case back to the Court of Appeals.

The takeaway: plan sponsors could not claim that a fund had been added to the plan so long ago that it was no longer subject to litigation. Instead, ongoing monitoring requirements necessitate that plan fiduciaries continually monitor the efficacy of funds in the plan.

More recent lawsuits have even sought to extend this principle. Complaints have been filed against fiduciaries of large DC plans alleging that using even a very low-priced fund (e.g., an index fund charging 4 basis points) violates ERISA when there is an even-lower-priced fund available for the identical investment strategy (e.g., based on the same index). These complaints also allege that ERISA is violated when a plan menu includes a mutual fund where there is a lower-priced investment vehicle (e.g., a separate account or collective trust) available using “the same investment managers as mutual funds with the same investment style.” Finally, these complaints allege it is imprudent to select a high-priced actively managed fund of a particular style (e.g., small cap value) when there are lower-priced alternatives that have the same “style.” This claim is given more credibility when the higher-priced alternative underperforms the lower-priced one or the relevant benchmark. If a fund offers a lower-fee share class or there is another identical lower-fee alternative than the one used in the plan, it is important for plan sponsors to document why the plan does not take advantage of it (e.g., insufficient assets).
Revenue-Sharing Arrangements

Revenue-sharing arrangements—which essentially use a portion of investment management fees to pay for recordkeeping and trustee services—have been popular with plan sponsors. However, they have recently become a target of litigators. While they are not illegal, they do present challenges for fiduciaries trying to evaluate the reasonableness of fees. Revenue-sharing arrangements are often:

**Less transparent.** Determining how much the plan is actually paying for recordkeeping services can be challenging because the fees are embedded in fund expense ratios.

**Asset-based.** This creates several problems:

- Fees increase when total plan assets increase, despite no change in services or service quality. As such, it is important to evaluate regularly the amount of revenue sharing paid to ensure it remains reasonable.
- The emerging best practice for recordkeeping services is a per capita fee. To determine reasonableness, the assets-under-management fee has to be “translated” into a per capita fee.
- Revenue-sharing fees are generally charged only on certain funds (e.g., for U.S. large-cap growth but not on company stock). As such, only those participants invested in funds with revenue sharing pay recordkeeping costs for services that are generally enjoyed by everyone in the plan. Plans can establish a reallocation process to correct unequal payments—but it is usually complicated (see inset box on the following page, “Challenges in Eliminating Revenue Sharing from the Plan”).

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**Strategies for managing plan fees**

- Conducting annual fee reviews (investment management, administrative, and other plan fees).
- Identifying situations in which a lower-priced share class or identical fund is available (e.g., collective trusts that deliver the same investment result as a mutual fund) and documenting reasons for picking “higher-priced alternatives.” For instance, noting that the plan does not qualify for investing in a lower-priced alternative because of asset size.
- Adopting a fee payment policy either as part of the Investment Policy Statement or as a separate document. Fee payment policies outline who is responsible for paying plan fees (plan sponsor versus participant), establish the method of fee payment (asset-based versus out of pocket), and define acceptable fee payments sources (such as use of revenue sharing).
Challenges in Eliminating Revenue Sharing from the Plan

Eliminating revenue sharing altogether from DC plans is an approach that more and more plan sponsors aspire to. According to Callan’s 2016 Defined Contribution Trends Survey, 44% of plans with participant-paid administrative fees use no revenue sharing, up from 29% in 2012. However, there can be challenges to moving to a revenue sharing-free DC plan:

- Certain investment strategies are only available in mutual funds with revenue sharing—no institutional share classes or collective trust offerings are available.
- Plans may not qualify for institutional share classes that eschew revenue sharing because of the size of assets in the plan.
- Institutional share classes may have lower aggregate fees because they do not have revenue sharing—but their investment management fees may actually be higher than the retail share class. In this case, moving to such share classes could actually increase overall plan costs (when out-of-pocket administrative fees are added in).

Callan recommends a disciplined approach to revenue-sharing arrangements, including:

- Be clear about what you are buying with revenue sharing; it often pays for more than just recordkeeping (e.g., a sophisticated participant education program may be included).
- Document exactly how much revenue sharing you pay for each service each year, and make sure you can defend that number as reasonable.
- Adopt a procedure for allocating revenue-sharing fees that you can defend as reasonable.
- Evaluate emerging best practices when it comes to revenue sharing, which include:
  - Capping the amount of revenue sharing permitted to be directed to pay for plan administration fees.
  - Designing plan reimbursement accounts that direct excess revenue sharing to pay for additional plan services or to be rebated back to plan participants.
Whatever approaches are used, it is important that plan sponsors can defend the fees plan participants are paying as reasonable and competitive. Recent DC plan fee lawsuits have taken the position that plan sponsors should take their plan out to bid every three to five years in order to ensure that administrative fees are competitive. This can be done through an RFI or an RFP process.

**Expense Reimbursement Accounts**

The Department of Labor has not opined on revenue sharing in detail. In July 2013, the Department of Labor issued Advisory Opinion 2013-03A on whether revenue-sharing payments constitute “plan assets” under ERISA. It asserted that revenue-sharing payments are not assets of a client plan until the plan actually receives them, or unless there is a contract in place obligating the recordkeeper to pay a certain amount to the plan. The Advisory Opinion noted that plan fiduciaries must act in the best interests of plan participants in negotiating the specific formula and methodology under which revenue sharing will be credited to the plan. Further, plan fiduciaries must periodically monitor that the amount to which the plan is entitled under revenue-sharing reimbursement arrangements is correctly calculated and applied for the benefit of the plan. The Advisory Opinion states, “Thus, in considering whether to enter into an arrangement of this kind, the fiduciary should take into account its ability to oversee the service provider.”

Another consideration around expense reimbursement and revenue-sharing rebating arrangements is the operational capabilities of recordkeepers. According to Callan’s 2016 recordkeeper questionnaire, most major recordkeepers are able to rebate revenue sharing. However, some could only do so at the trust level (but not to the individual participant account that generated the revenue sharing), some required that the funds be unitized in order to rebate back to individual participants, and others could only calculate the rebate on a quarterly basis. Further, the extent to which the rebating functionality is automated will vary by recordkeeper.

**Action Items**

- Review service provider compensation disclosures
- Review and benchmark plan fees
- Engage in a competitive bidding process for plan administration fees every three to five years
- Review and document investment vehicles used
- Evaluate current best practices in plan fee payment approaches
6. Oversee Required Employee Communications

Plan administrators have a number of “disclosure” obligations under ERISA. Disclosure requirements for investments are complex and largely beyond the scope of this handbook. At a high level, plan sponsors must provide a chart with the following information about the plan’s fund menu choices, permitting a straightforward comparison:

- Identifying information
- Performance data
- Benchmark data
- Investment-related fees

These rules apply only to designated investment alternatives. As such, they generally do not apply to brokerage windows (described in Appendix II).

Participant Investment Education and Advice

ERISA does not require that plan fiduciaries provide participants with investment education or advice beyond a basic description of how the plan works and the characteristics of the available investment options. However, most sponsors arrange for some education or advice, typically from a third party (unaffiliated with any of the plan’s funds) or one or more of the plan’s fund providers.

Simple investment “education” (as distinguished from “advice”) is generally not subject to ERISA fiduciary rules, including the 2016 Advice Fiduciary Rule. Indeed, the Advice Fiduciary Rule generally adheres to prior guidance by defining non-fiduciary education as: providing information about the plan and how it works, as well as general investment concepts (e.g., risk and return, diversification, and dollar-cost averaging).

With respect to asset allocation models, non-fiduciary investment education for plan participants can identify a specific investment alternative if it is a designated investment alternative under the plan, subject to oversight by an independent plan fiduciary. This rule applies so long as the model:

1. Identifies all other designated investment alternatives available under the plan that have similar risk and return characteristics, if any; and
2. Is accompanied by a statement indicating that those other designated investment alternatives have similar risk and return characteristics, and identifying where information on those investment alternatives may be obtained. “Interactive investment materials” (e.g., a software program) may also identify a specific investment alternative or distribution option, subject to similar rules.

However, the 2016 Advice Fiduciary Rule triggered a critical change with respect to advising plan participants on termination of employment. Generally speaking, it is not a fiduciary act under the rule to provide general information about the options available to plan participants upon termination (e.g., that they may keep assets in the plan, take a withdrawal, or rollover their assets into a new employer plan or IRA). However, specific direction about rollover options would be considered fiduciary advice. Historically, recordkeepers have regularly had benefits center representatives engage in such conversations with plan participants, and have built in rollover capture from such conversations into recordkeeping revenue models. Plan sponsors should fully understand how
recordkeepers are approaching these—or any fiduciary conversations—within the Benefits Center under Department of Labor’s new rules.

When an unaffiliated third party provides education/advice, plan fiduciaries are only responsible for ensuring that the provider is competent and the education/advice is generally prudent. When one of the plan’s fund providers offers advice/education, additional rules apply. Generally, the provider must qualify for either the “flat fee” exemption or the “model-driven advice” exemption.\(^1\) The plan’s legal counsel should review this issue with the plan provider. Education or advice fees that are passed onto the participant should be reasonable, and should be regularly reviewed and documented.

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**Action Items**

- Update on DC best practices, regulation, litigation to understand the evolving education/advice environment
- Review approach that services providers are adopting to investment communication, education, and advice in light of the 2016 Advice Fiduciary Rule

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\(^1\) The Department of Labor exempts advice providers from prohibited transactions provided advice is based on a computer model, or if the advisor is paid a flat fee that does not change based on investment choices.
7. Review Overall Plan Utilization

A review and evaluation of how employees are utilizing the DC plan is a good management practice, although it is not required by ERISA. Such a review includes:

- Participant asset allocation decisions
- Transfer activity
- Participation levels
- Participant deferral levels
- Loans and withdrawals

A regular evaluation of plan usage can help officials understand what adjustments to plan design, delivery, and communication might be required to achieve better outcomes. This could include implementation or modification of automatic enrollment/escalation provisions, implementation or modification of investment defaults, changes to the investment fund lineup, implementation of advisory solutions, inclusion of retirement income solutions, and development of targeted communications.

Action Items

- Recordkeeper/Trust & Custody plan report review – To understand plan participant behavior
- Retirement benefit and settlor decisions/strategy update – To determine if plan provisions meet the needs of the company and plan sponsor
- DC best-practices, regulation, litigation – To understand how the plan measures up to other plans
8. Review Defined Contribution Trends and Overall Plan Effectiveness

Increasingly, plan officials are also evaluating overall plan effectiveness, using measures such as a retirement income adequacy analysis. This involves projecting expected income levels that the plan is likely to generate for participants in retirement, given contribution levels, available investments, time horizon, etc.

There is currently no requirement under ERISA to perform such evaluations. However, this type of analysis can be useful in understanding the extent to which plan design (including TDF design) can help workers achieve their retirement goals.

Action Items
- Recordkeeper/Trust & Custody plan report review: Review aggregate data on retirement income replacement levels
- DC best-practices, regulation, litigation: To understand how the plan measures up to other plans
Conclusion

Taking responsibility for a DC plan can be daunting, with plan fiduciaries facing personal liability in the event that the plan is found to be improperly managed. However, having a thorough process in place can do much to mitigate fiduciary risk and help plan officials maintain a high standard of care, ideally leading to strong outcomes for plan participants.

- **Appendix I** contains a sample DC Plan Governance Committee Meeting Rolling Agenda. This includes descriptions and roles for various quarterly and annual tasks, such as reviewing and approving minutes, investment performance review, plan report review, and DC best practices review.
- **Appendix II** covers special issues surrounding the use of company stock and brokerage windows in the DC plan.
- **Appendix III** contains a Fiduciary Checklist to help plan sponsors stay on track with fiduciary requirements.
Appendix I

DC Plan Governance – Committee Meeting Rolling Agenda

See the following page for detailed descriptions of each bulleted agenda item.

Assumes: ERISA-regulated plan, joint investment/administration committee, calendar year

First Quarter (May)
- Review/approve minutes, follow-ups
- Investment performance review
- Watch list review*
- Recordkeeper/Trust & Custody plan report review
- New committee members – plan overview (as applicable)
- Update on DC best practices, regulation, litigation
- Manager presentation(s)

Alternate structure: Conduct manager presentations during a separate, annual two-day session

Third Quarter (November)
- Review/approve minutes, follow-ups
- Investment performance review
- Watch list review*
- Review plan QDIA: objective, methodology, implementation, fees, scenario/outcome testing, communication materials
- Review plan investment options: fees, performance attribution, allocation structure and factor exposures (if multi-manager), organization updates
- Manager presentation(s)

Second Quarter (August)
- Review/approve minutes, follow-ups
- Investment performance review
- Watch list review*
- Service provider compensation disclosures** [ERISA 408(b)(2)]
- Review/confirm participant disclosures*** [plan documents, factsheets, 404(a)(5), other 404(c) required items]
- DOL filings, compliance checklist review***
- Fiduciary training (markets, regulations, plan administration)***
- Manager presentation(s)

Fourth Quarter (February)
- Review/approve minutes, follow-ups
- Investment performance review
- Watch list review*
- Retirement benefit – Settlor decisions/strategy update***
- Investment policy statement (IPS) review***
- Investment markets review, outlook, CMA updates
- Manager presentation(s)

* If applicable, per the investment policy statement.
** Sponsor is responsible for initial 90-day review of new or updated disclosures. Callan recommends a periodic fee benchmarking exercise designed specifically for the type of service provider being evaluated, e.g., investment manager vs. recordkeeper.
*** Supervised by sponsor’s ERISA counsel.
## Sample Agenda Item Detail

<table>
<thead>
<tr>
<th>Fiduciary Task</th>
<th>Description</th>
<th>Responsibility</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Quarterly</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Review/approve minutes, follow ups</td>
<td>Typically one committee member is assigned to introduce last quarter’s minutes</td>
<td>Plan sponsor staff</td>
</tr>
<tr>
<td>Investment performance review</td>
<td>Review investment performance, highlight recent notable developments</td>
<td>Consultant</td>
</tr>
<tr>
<td>Watch list review (as applicable)</td>
<td>Run any prescribed process for investments deemed to warrant additional scrutiny</td>
<td>Consultant</td>
</tr>
<tr>
<td>Manager presentation(s)</td>
<td>Invite investment managers (preferably the portfolio manager) to review strategy in person with the committee</td>
<td>Investment manager(s)</td>
</tr>
<tr>
<td><strong>Annually</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Recordkeeper/Trust &amp; Custody plan report review</td>
<td>Annual report from recordkeeper that describes the plan, its assets, its participant demographics, and investment activity</td>
<td>Recordkeeper, with input from staff and consultant on items of note</td>
</tr>
<tr>
<td>New committee members – plan overview</td>
<td>Introduce retirement benefit objectives and plan features to new committee members</td>
<td>Plan sponsor staff, with consultant support</td>
</tr>
<tr>
<td>Update on DC best practices, regulation, litigation</td>
<td>Overview of investment and governance trends affecting the DC marketplace</td>
<td>Consultant</td>
</tr>
<tr>
<td>Review plan QDIA: objective, methodology, implementation, fees, scenario/outcome testing, communication materials</td>
<td>Review QDIA to ensure its alignment with plan objectives relative to participants’ long-term retirement savings needs</td>
<td>Consultant and plan sponsor</td>
</tr>
<tr>
<td>Review plan investment options: fees, performance attribution, allocation structure and factor exposures (if multi-manager), organization updates</td>
<td>Quantitative and qualitative review of plan investment options</td>
<td>Consultant and plan sponsor</td>
</tr>
<tr>
<td>Service provider compensation disclosures* [ERISA 408(b)(2)]</td>
<td>Confirm that the direct and indirect compensation to the plan’s service providers is reasonable in the opinion of the plan’s fiduciaries</td>
<td>Plan sponsor staff, ERISA counsel, support from consultant</td>
</tr>
<tr>
<td>Review/confirm participant disclosures** [plan docs, factsheets, 404(a)(5), other 404(c) required items]</td>
<td>Audit documents to ensure the disclosures are accurate and comply with DOL rules</td>
<td>Plan sponsor, recordkeeper, ERISA counsel, support from consultant</td>
</tr>
<tr>
<td>Plan compliance - status report**</td>
<td>Ensure compliance with DOL/IRS rules</td>
<td>Plan sponsor staff</td>
</tr>
<tr>
<td>Fiduciary training (markets, regulations, plan administration)**</td>
<td>Educating committee members on recent trends in the marketplace</td>
<td>ERISA counsel with support from staff and consultant</td>
</tr>
<tr>
<td>Retirement benefit – Settlor decisions/strategy update**</td>
<td>Review/updates to plan benefits, match levels, eligibility/vesting, retiree asset rules</td>
<td>Company board/plan sponsor</td>
</tr>
<tr>
<td>Investment policy statement (IPS) review**</td>
<td>To ensure the investment objectives and key governance procedures of the plan are documented as desired</td>
<td>Plan sponsor, ERISA counsel, support from consultant</td>
</tr>
<tr>
<td>Investment markets review, outlook, CMA updates</td>
<td>Review of capital markets and discussion of related effects relative to the plan’s investment objectives</td>
<td>Consultant</td>
</tr>
</tbody>
</table>

* Sponsor is responsible for initial 90-day review of new or updated disclosures. Callan recommends a periodic fee benchmarking exercise designed specifically for the type of service provider being evaluated, e.g., investment manager vs. recordkeeper.

** Supervised by sponsor’s ERISA counsel.
Appendix II

Special Issues: Company Stock and Brokerage Windows

Company Stock

Many 401(k) plans allow investment in company stock. Some believe that company stock investments help align employee and company interests. Tax benefits are another potential benefit.

Company stock presents a number of challenges. It is effectively a “single stock fund,” and thus can present special risks that would otherwise be “diversified out” in another investment, such as a mutual fund. (There is an exemption from ERISA's diversification requirement with respect to company stock, if certain conditions are met, to address this issue.)

Company stock funds are volatile, creating potential for participants to lose significant amounts of money. As a result, company stock is one of the most litigated issues for 401(k) plan sponsors, and the applicable rules—as interpreted by the courts—remain unclear.

In 2014, the Supreme Court found that the law does not create a special presumption of prudence for employee stock ownership plan (ESOP) fiduciaries, thereby negating a DC stock-drop defense that had been upheld by most Circuit Courts prior to the ruling. Instead, the Supreme Court laid out alternative defenses for ESOP fiduciaries that may be helpful in understanding fiduciaries’ monitoring responsibilities with respect to company stock. In its decision, the Supreme Court noted that:

With respect to the role of public information in decision making: Because markets are efficient, plaintiffs must demonstrate that there were special circumstances making it imprudent for fiduciaries to rely on market prices in evaluating the efficacy of the company stock. (Note: The Court declined to speculate what “special circumstances,” if any, could give rise to a claim.)

With respect to the use of inside information: In order to state a claim for breach of the duty of prudence on the basis of inside information, plaintiffs must plausibly allege an alternative action that the defendant could have taken that would have been consistent with securities laws, and that a prudent fiduciary in the same circumstances would not have viewed as more likely to harm the fund than to help it.

As DC stock drop cases continue to be litigated, clearer guidelines for the appropriate monitoring of employer stock will emerge.

Brokerage Windows

Generally, brokerage windows (self-directed brokerage) allow participants to invest in funds or securities that are not part of the plan’s main menu. A brokerage window can be limited to a selection of mutual fund families carried on the recordkeeper’s platform. Alternately, “full brokerage” enables access to stocks, exchange-traded funds, and other securities.
Brokerage windows can be an effective tool to: (1) allow plan participants who are sophisticated investors (e.g., participants using an account manager/advisor) to access investments otherwise unavailable and (2) deal with pressure to increase the number of fund options available in the core fund menu.

Brokerage windows present certain risks. Fees can be higher, evaluation of investment choices by participants could require a high level of investment sophistication, and some investments (e.g., very aggressive mutual funds or single stocks) may be volatile and present significant risk to the participant.

Whether or not plan sponsors are required to monitor the investments within a brokerage window is an area of considerable debate. Many plan sponsors that offer brokerage windows take the position that it is not necessary to monitor the individual investments in the brokerage windows, as they are not “designated investment alternatives.” However, the Department of Labor has considered requiring greater oversight in this area.² Generally, it is considered a best practice to ensure that the brokerage window operates in a reasonable manner and with reasonable fees.

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² In 2012 the Department of Labor sought to require greater plan sponsor oversight of self-directed brokerage accounts in a field assistance bulletin (FAB). Lawmakers took exception, contending that the Department of Labor was inappropriately using the FAB to issue new regulation without a comment period. The DOL subsequently removed the self-directed brokerage account disclosure requirement from the FAB.
Appendix III

Sample Fiduciary Checklist

A checklist can help to ensure that each fiduciary task has been completed as scheduled. We provide a sample checklist with the recommended timing for each activity within a calendar year (e.g., complete annual plan fee monitoring and benchmarking in the third quarter). Click here to download a version of this checklist that can be customized for your fund.

<table>
<thead>
<tr>
<th>Task</th>
<th>Recommended Timing</th>
<th>First Quarter</th>
<th>Second Quarter</th>
<th>Third Quarter</th>
<th>Fourth Quarter</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adopt an investment policy statement and investment structure</td>
<td>At outset</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>QDIA oversight: evaluate and monitor the glide path of the target date fund</td>
<td>Periodically*</td>
<td></td>
<td>✓</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Review and monitor investment manager performance</td>
<td>Quarterly</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Monitor and benchmark plan fees</td>
<td>Annually</td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Review overall plan utilization</td>
<td>Quarterly</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Ensure that required employee communications are properly executed</td>
<td>Annually</td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Review the investment policy statement</td>
<td>Annually</td>
<td></td>
<td></td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Review DC trends and overall plan effectiveness</td>
<td>Annually</td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Evaluate and update the investment structure</td>
<td>Periodically**</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* See page 8.
** See page 4.
Author

Lori Lucas, CFA, is an Executive Vice President and Defined Contribution Practice Leader at Callan Associates. Lori is responsible for setting the direction of Callan’s DC business, providing DC support both internally to Callan’s consultants and externally to Callan’s clients, and developing research and insights into DC trends for the benefit of clients and the industry. Lori is a member of Callan’s Management Committee and is a shareholder of the firm.

Formerly, Lori was Director of Retirement Research at Hewitt Associates. Lori has also served as a vice president at Ibbotson Associates, a pension fund consultant at J.H. Ellwood & Associates, and an analyst and product development leader at Morningstar, Inc.

Lori received a Masters from the University of Illinois and a BA from Indiana University. Additionally, she earned the right to use the Chartered Financial Analyst designation. Lori is a former columnist for Workforce Management online magazine and her views have been featured in numerous publications. She is the Chair of the Defined Contribution Institutional Investment Association, former Executive Chair of the Employee Benefit Research Institute’s Research Committee, and a member of NAGDCA. Lori is also a frequent speaker at pension industry conferences.