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Fiduciary Committee Best Practices – Part I: The Basics

Even in areas of law where the landscape of rules, regulations, and risks seems constantly to be changing, certain core concepts and basic principles hold fast. In the case of fiduciary responsibility under ERISA, the core concepts and basic principles can be boiled down to three key elements: (1) establish a prudent process; (2) adhere to the process; and (3) document the process. These principles apply no matter what kind of benefit plan is involved (if it is governed by ERISA) and no matter what role the fiduciary plays in the operation of the plan. And courts have affirmed the strength and validity of these principles time and time again even when the decisions made by fiduciaries look really bad in hindsight. In this first part of a two-part series we will highlight five best practices that we recommend to any employer who maintains a retirement plan is subject to ERISA. These practices apply to both defined contribution plans where participants typically control the investment of their individual accounts (such as 401(k) plans and 403(b) plans that include employer contributions) and defined benefit pensions plans (where the investment risk is essentially on the employer). The key fiduciary responsibility requirements of ERISA do not vary based on the size or sophistication of the employer. Therefore, while the implementation of these best practices may vary to some extent based on the size and sophistication of the employer, the efficacy of the practices will not.

Establish a committee. Every ERISA plan has one or more fiduciaries as a matter of law. Unless an employer takes affirmative steps to appoint fiduciaries and delegate authority to them, the employer will be treated as the fiduciary and will be held to the high standards of ERISA if has carried out fiduciary functions – for example, exercising authority or control over the administration of the plan or the investment of plan assets. We recommend that employers take some of the guess work out of the equation and make formal appointments of plan fiduciaries. And since a small, dedicated group of informed people with relevant experience are more likely to make good decisions consistently than a single overworked person, we recommend that employers: (a) establish a committee to oversee the general administration of their retirement plans; and (b) specify the scope of fiduciary authority and responsibility delegated to the committee. Given the nature and complexity of the work, we recommend that an employer appoint a dedicated investment committee to oversee the investment of plan assets. However, many employers make do with a single committee that serves as "plan administrator" (a term that appears in every retirement plan document and a role that allows the group to make decisions regarding eligibility, vesting, and benefits if necessary) and will also oversee the investment of plan assets. In the case of a 401(k) or 403(b) plan, oversight of plan investments will primarily involve the selection of the investment fund line up, the monitoring of fees and investment performance, and the monitoring of investment service providers. Let the role and responsibilities of the committee guide your choices for committee members. So if the committee will have responsibility of plan investments, it will make sense to include members with significant experience dealing with financial matters and working with investment concepts. A typical plan administrative committee will include three to five members, drawn from the human resources and finance departments of the employer, with someone from legal added if the

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employer is large enough to have a legal department. If an employer chooses to appoint a separate committee to deal with plan investments (which is fairly common among large employers), the committee members can and should be more specialized. Ideally, the committee or committees will be appointed by the Board of Directors in a formal action that includes an explicit delegation of authority.

Adopt a charter. Just as a corporation adopts bylaws to create a governance structure and operating rules, so should a fiduciary committee adopt a charter to structure its operations. A charter need not be voluminous, but it should contain some basic elements that will help direct the activities of the committee. At a minimum, the charter should: (a) affirm the scope of authority delegated to the committee and describe specific responsibilities to be carried out by the committee; (b) identify the members of the committee, often done by referring to titles or positions, rather than by name; (c) describe how committee members may be appointed and replaced; and (d) state how often the committee intends to meet. We recommend quarterly meetings, but a minimum of semi-annual meetings seems prudent for any committee that has responsibility for the investment of plan assets. Like any important corporate policy, the charter should describe rules that serve a defined compliance goal and with which the employer is willing to live. If there is one thing worse than not having a prudent policy in place, it would be having a policy and not following it.

Adopt an investment policy statement. If the committee has responsibility for the investment of plan assets, it should absolutely adopt a statement of investment policy (or investment policy statement). The investment policy statement need not - and probably should not - be a dense, encyclopedic guide to every investment vehicle and analytical method that could be brought to bear in selecting plan investments. Neither should the statement create inflexible restrictions that could force the committee to take a given action, or refrain from taking an action, where circumstances seem to require something different. But the investment policy statement does need to provide meaningful guidance to committee members in fulfilling their responsibilities by: (a) confirming the goal of, and strategy for, providing a widely diversified line up of prudent investment options; (b) identifying the factors that will be considered in selecting and, when necessary, eliminating investment funds, including fees, performance, and other factors; and (c) describing activities that the committee will undertake to monitor the performance of investments and investment advisors. It is important that the policy statement be written in a way that committee members understand. An investment policy statement that amounts to a long, highly technical description of the analytical methodology applied by the investment advisor engaged by the committee is neither necessary nor helpful to the committee.

Use experts (as needed). It is well established that courts apply a "prudent expert" standard of care under ERISA, not a "prudent person" standard. That means that if the members of a fiduciary committee lack the expertise necessary to fulfill their duties under a given set of circumstances, the committee must find the expertise elsewhere. In almost every case, a fiduciary committee will benefit from the engagement of an independent advisor to assist with the selection and monitoring of plan investments. (The relevant standard is NOT what you might do in investing your own money; it's what an expert would do in investing someone else's money.) Note that the selection of plan service providers, including an investment advisor, is itself a fiduciary act and must be undertaken through a prudent process. Although a formal RFP process is not necessarily required, a committee will certainly want to receive proposals from several advisory firms, compare fees and services, obtain references, and interview at least two finalists before making a selection.

Keep minutes. Three of the four best practices identified in this article so far have included an element of documentation - the appointment of a committee (where a formal designation and delegation are recommended), the adoption of a charter by the committee, and the adoption of an investment policy statement by the committee. We will now make it four out of five: the business taken up and decisions made at each meeting of the committee should be documented in written minutes. Minutes of the meeting should be taken contemporaneously, should include as attachments any written materials presented at the meeting, and should be maintained in a safe place and in an orderly manner. Without minutes, it will be difficult demonstrate the process followed by plan fiduciaries no matter how prudent it may have been. We will have more to say about this in Part 2 of this series.

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