Fiduciary Governance: A Map to Success

Part 2

This is the second part of our discussion of Fiduciary Governance: A Map to Success. We began the first part by saying that “Companies that sponsor retirement plans, such as 401(k) plans, have responsibilities, both legal and practical, that, if properly fulfilled, can help their employees achieve financial security in retirement and that can reduce the risk of lawsuits and government investigations. The key words are “if properly fulfilled”.”

As Part 1 explained, an important part of properly fulfilling fiduciary responsibilities is to seek the advice of knowledgeable persons to help understand your fiduciary responsibilities and then to help with the information and decisions about the plan’s investments, service providers, and operation. This Part covers key questions to ask candidates to be your plan advisor.

A qualified fiduciary advisor can help you—the fiduciaries--do “well”—by avoiding legal problems, while doing “good”--by helping employees save for a secure retirement.

Here are some of the important questions to ask advisors:

DO YOU WORK WITH OTHER PLANS SIMILAR TO OURS?

The size of a plan, for example, a 401(k) plan, can make a real difference in terms of the available investments, providers, and fees and costs. It shouldn’t come as a surprise that a $100 million plan has access to lower cost investments and is often served by different providers than a $1 million plan. The officers and managers who serve as fiduciaries, often as members of a plan committee, are best served by an advisor who has experience with plans of a similar size to theirs. The two most important determinants of “size” are total plan assets and number of participants.

In addition, a plan sponsor’s industry can make a difference in the plan’s design, services, investments and costs. For example, a law firm may have a 90% or higher participation rate and, as a result, plan committee members may not need to focus on increasing enrollment. However, they may want to include a brokerage account window in the plan to give participants access a much larger range of investments. On the other hand, a hotel may have a large number of low paid employees for whom English is a second language and the plan might struggle to have a 50% participation rate. As a result, a hotel plan sponsor might benefit from having educational materials and enrollment meetings in both Spanish and English. As a third example, a manufacturing company may have a wide range of participating employees, both in terms of compensation and investment knowledge. That plan's participation rate might be in the 60% to 70% range. It may be well-served to use automatic enrollment, which could result in a participation rate of 90% and by defaulting employees into investment solutions, such as target date funds.

In each of these examples different plan designs, investments and services could make a meaningful difference in the success of the plan. Make sure an advisor has plan sponsor clients that are similar to your company.

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The starting point for a good process for selecting investments is to have an investment policy statement (IPS) that is an investment roadmap for the fiduciaries. Make sure the advisor's answer includes a description of how the advisor will help the fiduciaries develop and implement the IPS.

The advisor should explain that an IPS describes the criteria and process for selecting and monitoring a plan's investments. Plan fiduciaries should be able to read the IPS and understand the steps that they need to take in selecting, monitoring, removing and replacing investments.

For risk management, the most important consideration is whether the costs of the investments (called the "expense ratio") is no more than a reasonable amount. An advisor's answer to this question should cover how the advisor helps the fiduciaries know if their investment costs are reasonable, based on factors such as the available investments, the use of revenue sharing, and the total assets of the plan.

As mentioned, "revenue sharing" is an important consideration. The advisor should explain "revenue sharing" and whether it is appropriate for your plan and your objectives. Many mutual funds (and collective trusts) have several "share classes". (In essence, each share class is an interest in the same fund or trust but charges different expense.) A mutual fund may have a share class that pays revenue sharing to your service providers that helps cover the fees of those providers. It may have another share class that does not pay any revenue sharing (and in that case, the plan would need to cover the fees of the service providers). As you might imagine, the first share class is more expensive, while the second has a lower expense ratio. But which is better for your plan? An experienced will be able to explain how to get and evaluate that information, and which option best serves your plan.

Concluding Thoughts

The fiduciary "journey" can be a difficult one. It involves making decisions about unfamiliar issues, understanding different terminology and concepts, deciding what information a knowledgeable person would want to have, and on and on. Fortunately, fiduciaries are not expected to be experts on all those matters; instead, they can engage knowledgeable advisors who can provide the needed expertise and be a guide on the journey. In that case, the idea is that fiduciaries will "know that they don't know" and will get the help to do it right.

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