Trustee Responsibility in Defined Contribution (DC) Plans

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Welcome

• Focus on trustee responsibilities in defined contribution (DC) plans
• There’s a lot more topics than we can cover
• Picked out a few to discuss
First a Quiz—Show of Hands

• Are you?
  – A trustee
  – An administrator
  – Vendor/consultant/lawyer/other

• Biggest challenge
  – Administration?
  – Investments?
  – Other?
Managing a 401(k) Fund

Areas of responsibility

- Administration
  - Internal processes
  - Personnel
    - Internal personnel
    - External personnel
      - Third party vendors
      - Recordkeepers
- Investments
  - Deciding on the investment line-up
  - Monitoring specific investment managers
  - Monitoring performance and costs
What’s “Tricky” About 401(k) Plans

• 1st—Speed kills
• 2nd—Visibility/transparency
  – Errors show-up right away
  – Touches members’ paychecks
  – Investments can be judged
• 3rd—Correcting errors is tough
  – Things move fast in the wrong direction
  – Strong administrative oversight is important
Focus of Today’s Discussion

- Two major topics
  - Administration
  - Investments
- Administration
  - Internal administration
  - External administration
- Investments
  - Selecting
  - Monitoring

Communications

Slide 6
401(k) Administration

- Focus on a few “priorities”
- Administration relies on:
  - Internal resources
  - External resources
    - Vendors/recordkeepers
    - Employers
    - Accountants/consultants
401(k) Administration

- The information flow: How 401(k) work
  - Members elect to contribute (active or default)
  - Employer runs payroll
  - Payroll collects 401(k) deductions
  - Payroll data and money get to recordkeeper
  - Recordkeeper does two things:
    - Posts the deduction file to each member’s account
    - Deposits the deductions into each investment per the member’s direction
- Trustees—Need to understand and monitor the information flow:
  - Who’s involved in the file production?
  - Are things happening timely?
  - Are things happening correctly?
  - Is there a process to make sure things are done and done timely?
- Internal staff needs to monitor but trustees have a duty to monitor
401(k) Admin—Areas to Monitor

- External vendors—401(k) recordkeeper
  - Selection
  - Contracting
  - Performance monitoring

- Costs
  - Allocation of costs
  - Level of costs
  - Cost-sharing between funds
External Vendors—
401(k) Recordkeeper

• Selection Process
  – Seek experts in the marketplace
  – Detailed requirements are critical
  – Marketplace: Single-employer vs. multiemployer
    • Look for experience
    • Proactive process—head-off problems early
  – Do a site visit: Need to kick the tires
External Vendors—
401(k) Recordkeeper (continued)

• Contracting
  – My opinion: never “hire” anyone until you have an acceptable SIGNED contract (don’t forfeit your leverage)
  – Insist on meaningful service-level provisions:
    What’s it take to get the vendor’s attention

• Performance Monitoring
  – Pre-implementation audit
  – Conduct sufficient parallel testing (if possible)
  – Have internal staff routinely report on activities/problems
  – Seek union benefit rep input on quality

Live by the Cockroach Theory—there’s never just one . . .

Slide 11
401(k) Admin
Couple Problem Areas

• Auto-enrollment: Typical failures
  – Employer’s payroll didn’t know about auto-enrollment
  – No one negotiating the employer into the 401(k) plan realized that the plan called for auto-enrollment
  – Union members weren’t told that they need to un-enroll
    • Particularly problematic with members returning from layoff who previously opted out

• Plan loans
  – Enforcement of limits
  – Problems changing recordkeepers
    • Limited didn’t get transferred
401(k) Admin—ADP/ACP Testing

- Non-discrimination testing:
  - Very complicated
  - Only done annually
  - Easy to interpret data incorrectly
- Plan document governs testing
- Specific thoughts:
  - Add in as much flexibility as possible
  - Make sure the right groups are combined
  - Spend the time to make sure the data is accurate
401(k) Plans—Costs and Fees

- **Administrative charges**
  - Recordkeeping fees
  - Standard recordkeeping fee
    - Plan loans
    - QDROS
    - Hardship withdrawals
  - Communications pieces (SPD mailings)
  - Shared expenses with other funds

- **Participant-level activity fees**
  - Plan loan processing fee
  - QDRO fee
  - Brokerage window set-up fee

**Admin Costs**
Fees for 401(k) Investments

- Trustee sensitive area
  - Numerous lawsuits in the private employer arena
  - Intense DOL interest
- Understanding exactly who’s in-charge
  - 3(21) Fiduciary—Advisor “recommends”
  - 3(38) Fiduciary—Advisor “decides”
- Each role comes with different monitoring obligations
Investment Selection

- Selecting investments requires a rigorous process
  - Unless the fund has strong internal capabilities, most fund trustees will rely on external help
  - Trustees will have to decide how much discretion they want over investment selection
    - 3(21) Fiduciary—Advisor “recommends”
    - 3(38) Fiduciary—Advisor “decides”
- 401(k) plan do not require a specific number of investments
  - Employees do NOT have to be offered investment choice, but it’s rare not to do so
  - ERISA 404(c)—requires at least three investments
Investments: Common Challenges

- Types of investments (not an exhaustive list)
  - Annuity contracts
  - Registered mutual fund
  - Commingled account
  - Separately managed account

- What determines which type to use?
  - Principal aspect is asset size
  - Generally, the smaller the assets, the fewer the options
Investments: Monitoring

• Need to understand investment “fees”
  – Can’t monitor “fees” unless you understand
• What’s driving the intense focus on “fees”?
  – Federal Reserves Zero Interest Rate Policy (ZIRP)
    • Fees affect a large part of the total return
  – Realization that “actively” managed funds (which are generally more expensive) MAY NOT out perform “passively” managed funds
Investments: Fee Overview

- Costs associated with 401(k) plans
  - Admin costs
    - Recordkeeping
    - Staff administration
    - Outside administrative support
      - Accountants
      - Lawyers
  - Investment-related costs
    - Custodians/trustees
    - Investment advisors consultants
      - Internal staff
      - External consultants
    - Investment managers
      - People who actually “run the money”
Investments: Fee Overview (continued)

• Level of cost is determined by investment class and style
  – Active vs. passive investment fund
  – Domestic vs. international asset class
Investments: Revenue Sharing

- Mutual funds
  - Registered investments
  - Strict legal compliance
  - Anticipate large distribution costs
- Mutual fund rebates a legally disclosed portion of the fee the mutual fund collects back to the 401(k) recordkeeper
Investments: Revenue Sharing (continued)

• Why would a mutual fund pay a rebate?
  – Because it accumulates assets for which it incurs lower or no “distribution” costs

• Mutual Funds are “retail” investments (anyone can buy them)
  – Other investments are NOT available to individual investors either because the investor does not have sufficient assets to commit OR because the investor is not deemed to be sufficiently sophisticated to protect their own interests

• Key—be aware of them in benchmarking your plan’s total costs
## Sample Fee Chart

### Administrative Fees/ Costs

<table>
<thead>
<tr>
<th>Expense/ Fee Type</th>
<th>Fee or Cost</th>
<th>Count</th>
<th>Total Fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recordkeeping</td>
<td>$50 PMPY</td>
<td>50,000 Accts*</td>
<td>$2,500,000</td>
</tr>
<tr>
<td>Plan Loans</td>
<td>$50/Loan</td>
<td>2,000 Loans*</td>
<td>$100,000</td>
</tr>
<tr>
<td>QDROS</td>
<td>$500/QDRO</td>
<td>100 QDROS*</td>
<td>$50,000</td>
</tr>
<tr>
<td>Internal Staff Costs</td>
<td>$20,000</td>
<td>N/A</td>
<td>$20,000</td>
</tr>
<tr>
<td>Outside Expenses</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Legal</td>
<td>$30,000</td>
<td>N/A</td>
<td>$30,000</td>
</tr>
<tr>
<td>Accounting</td>
<td>$20,000</td>
<td>N/A</td>
<td>$20,000</td>
</tr>
<tr>
<td>Fund trustee costs</td>
<td>$10,000</td>
<td>N/A</td>
<td>$10,000</td>
</tr>
<tr>
<td><strong>Total Admin Fees</strong></td>
<td></td>
<td></td>
<td><strong>$2,730,000</strong></td>
</tr>
</tbody>
</table>

* - Based on actual activity and/or accounts

Slide 23
## Sample Fee Chart

### Investment Fees/ Costs

<table>
<thead>
<tr>
<th>Expense/ Fee Type</th>
<th>Fee or Cost</th>
<th>Assets</th>
<th>Total Fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trustee/Custodian</td>
<td>5 basis points</td>
<td>$500,000,000 Assets</td>
<td>$250,000</td>
</tr>
<tr>
<td>Investment Fund A</td>
<td>48 basis points</td>
<td>$100,000,000 Assets</td>
<td>$480,000</td>
</tr>
<tr>
<td>Investment Fund B</td>
<td>10 basis points</td>
<td>$200,000,000 Assets</td>
<td>$200,000</td>
</tr>
<tr>
<td>Investment Fund C</td>
<td>65 basis points</td>
<td>$50,000,000 Assets</td>
<td>$325,000</td>
</tr>
<tr>
<td>Revenue Sharing (Invest C)</td>
<td>(25) basis points</td>
<td>$50,000,000 Assets</td>
<td>($125,000)</td>
</tr>
<tr>
<td>Investment Fund D</td>
<td>30 basis points</td>
<td>$100,000,000 Assets</td>
<td>$300,000</td>
</tr>
<tr>
<td>Investment Fund E</td>
<td>75 basis points</td>
<td>$50,000,000 Assets</td>
<td>$375,000</td>
</tr>
<tr>
<td>Revenue Sharing (Invest E)</td>
<td>(10) basis points</td>
<td>$50,000,000 Assets</td>
<td>($50,000)</td>
</tr>
<tr>
<td>Investment Consultant</td>
<td>$50,000/year</td>
<td>N/A</td>
<td>$50,000</td>
</tr>
</tbody>
</table>

### Total Investment Costs

$1,805,000
## Sample Fee Chart

<table>
<thead>
<tr>
<th>Expense/ Fee Type</th>
<th>Total Fee</th>
<th>Per Account (50,000 accounts)</th>
<th>Per Dollars Held ($500,000,000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Admin Costs</td>
<td>$2,700,000</td>
<td>$36.10/account</td>
<td>36.1 basis points</td>
</tr>
<tr>
<td>Investment Fees</td>
<td>$1,805,000</td>
<td>$54.00/account</td>
<td>54.0 basis points</td>
</tr>
<tr>
<td><strong>Total Fees</strong></td>
<td><strong>$4,505,000</strong></td>
<td><strong>$90.10/account</strong></td>
<td><strong>90.1 basis points</strong></td>
</tr>
</tbody>
</table>

### Considerations in benchmarking costs:

- Tally the information such that you can easily benchmark it
- Most benchmarks are ranges with a low, midpoint and high
- Look to reconcile the costs with the Plan’s 5500
  - Adjustments will need to be made, but it will help focus the analysis
Investments: Name Brand vs. White Label

- **White Labeling Investments**
  - Hire investment managers, but communicate investment as “asset class”—not specific to manager
  - Example:
    - Dodge & Cox International Value Fund
    - International Value Fund (Active)

- **Benefits**
  - Easier to change underlying managers
  - Allows investment to contain several managers of the same investment style

- **Drawbacks**
  - Net asset value won’t be published publicly
  - Slightly more expensive to operate
    - Custodian/trustee will want more money to calculate the daily NAV
Thoughts on Monitoring and Re-competing

• Administration services
  – You’ll need someone close to the market
  – They should understand the capabilities available as well as benchmarking costs
  – Need to be VERY proficient in gathering requirements
  – Meaningful “service level agreements” (metrics)

• Investment services
  – Need an investment professional that understands the universe of available options
  – Look for someone who understands how to tally all your fund’s costs and fees
  – Look for proficiency in communicating investment options—can they help you make things simple?
Thoughts on Monitoring and Re-competing (continued)

• Frequency of re-competing vendors
  – Consider every three to five years for administrative support
  – Review fund manager performance at least semi-annually
    • Make sure you understand the investment style/objective the fund manager is applying and that the “benchmark” is appropriate
DOL Fiduciary Regs

• Affects individuals giving investment advice
  – DOL is particularly concerned about rollovers

• Rollover discussions
  – Work with legal counsel
  – Make sure your understand what people are being told
  – Duty to monitor fiduciaries
Session #F02

Trustee Responsibility in Defined Contribution (DC) Plans

- Recognize 401(k) plans are different
  - Speed and transparency demand tighter administration

- Monitoring the plan’s service vendors is important
  - Need strong contract provisions
  - Strong coordination between vendors, the union reps and company management (payroll and HR)

- 401(k) trustees have a very visible role
  - Easy to “Monday-morning” quarterback
  - Good communications and processes are key to success

Website Resources
2017 Educational Programs
Fiduciary Responsibility

63rd Annual Employee Benefits Conference
October 22-25, 2017
Las Vegas, Nevada
www.ifebp.org/usannual

New Trustees Institute—Level I: Core Concepts
February 20-22, 2017
Lake Buena Vista (Orlando), Florida
October 21-22, 2017
Las Vegas, Nevada
www.ifebp.org/trusteesadministrators

Trustees and Administrators Institutes
February 20-22, 2017
Lake Buena Vista (Orlando), Florida
June 26-28, 2017
San Diego, California
www.ifebp.org/trusteesadministrators

New Trustees Institute—Level II: Concepts in Practice
October 21-22, 2017
Las Vegas, Nevada
www.ifebp.org/trusteesadministrators

Related Reading
Visit one of the on-site Bookstore locations or see www.ifebp.org/bookstore for more books.

Trustee Handbook:
Item #7068
www.ifebp.org/books.asp?7068