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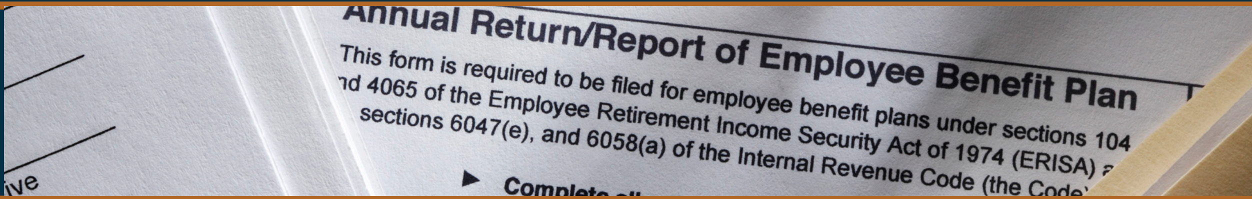

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Guide for 401(k) and 403(b) Plan Administrators

While a 401(k) or 403(b) plan has now been the primary retirement planning vehicle in most companies' benefits programs for a decade or more, the way in which companies approach the administration of such plans has varied widely. In the last few years, new regulatory initiatives by the Department of Labor, as well as a sharp spike in litigation against plan sponsors and third party record keepers, have underlined the importance of addressing plan administration in a proactive and comprehensive way. In that spirit, we offer this guide to employers as they administer their 401(k) or 403(b) plans.

1. Plan Document and Other Governing Documents

We start with the Plan document, which is adopted by the company in its role as plan sponsor. In this role, the company is not a fiduciary. It can design the plan in any way it chooses - just as it can decide to have no plan at all. It can choose a safe-harbor design to avoid some of the nondiscrimination testing that would otherwise apply. It can decide whether participants will be able to direct their own investments. These decisions will all be reflected in a plan document, and the plan will then have to be administered in accordance with the plan document.

The plan administrator should always have ready access to the current plan document. This sounds simple, but the way in which many plans are currently designed makes it less so. There are commonly two types of 401(k) or 403(b) plan documents: an individually designed document, that is drafted from scratch by the plan sponsor with the help of its attorneys, and a form document with standard language, often called a prototype or volume submitter document, that is drafted by a third party administrator (an outside company in the business of providing services to retirement plans, often referred to as the TPA) and then customized (as permitted by the document) to meet the specific needs of the plan sponsor. Many prototype and volume submitter plans that are offered by TPAs have a base document and an adoption agreement. The adoption agreement is where all of the design decisions are reflected, and where the signature and date of the plan sponsor appear. But not all of the plan provisions are in the adoption agreement. In order to effectively administer the plan, the plan administrator must have ready access to both the base plan document and the adoption agreement.

There are other documents that are important in the governance of the plan. One is the trust agreement. Most every plan must have a trustee who holds legal title to the assets. (There is an exception when an insurance company is involved - an annuity contract will take the place of the trust agreement.) Another important document is the services agreement, which is between the company as plan administrator and the third party servicer.

Some plan administrators decide to retain independent fiduciaries to assist them in carrying out their duties. In those cases, there will be a written agreement setting forth the duties of the independent fiduciary. The role of an independent fiduciary may be to give investment advice or provide recommendations to the plan administrator - in which case the independent fiduciary is sometimes referred to as a 3(21) fiduciary (named after ERISA section 3(21)). Alternatively the independent fiduciary may actually be given the final authority for choosing investments, in which case the independent fiduciary is sometimes referred to as a 3(38) fiduciary, named after ERISA section 3(38). The plan administrator not only should have a copy of the agreement with the independent fiduciary, but also understand the role the independent fiduciary will be serving.

2. Plan Administrator

Every plan will identify the plan administrator (as defined in section 3(16) of ERISA) and set forth its role. The plan administrator is the fiduciary who carries out plan administration and makes sure that the plan is being operated in compliance with applicable law and in accordance with the plan document. In this guide, we are assuming that the powers and duties of the plan administrator will be typical, but there is no substitute for reviewing the plan document.

Sometimes the plan document will identify a committee or individual (by title, usually) to be the plan administrator. But more often, the plan document simply will name the company as the plan administrator, and allow the company to delegate its responsibilities to someone other than the board of directors or chief executive officer - such as a committee. Smaller companies may delegate powers to one individual rather than a committee.

When the company is both the plan sponsor and plan administrator - which is typically the case - it is very important that the individuals serving as plan administrator understand the distinction. As plan sponsor, the company can make decisions about the plan (usually referred to as “settlor” decisions) that are detrimental to the participants - like lowering the match rate. But as plan administrator, the company must operate and administer the plan as it has been designed by the plan sponsor, and act in the best interests of the participants - in short, the plan administrator must be doing what is best for them.

This distinction can present difficulties when, at a single meeting, the same individuals are discussing plan sponsor issues - like lowering the match - and plan administrator issues - like changing the investment options in the fund lineup. It is important that these individuals be aware of this complexity, and not allow the two roles to bleed together or blur. The minutes of periodic meetings - see 5(d) below - should reflect this distinction.

3. The Summary Plan Description

It is important for the plan administrator to understand that the summary plan description is not the plan document - it is just a summary written for the participants. In making judgments about what the plan provides, reference should be made to the plan document, and not the summary plan description. Technically, it is the duty of the plan administrator to draft the summary plan description - it is a fiduciary act. But as a practical matter, the summary plan description is typically generated by the third party who generated the plan document if a prototype or volume submitter document is used. The summary plan description must be updated and redistributed to all plan participants every five years, or sooner if a material change is made to the plan.

4. Initial choice of investment options

In general the choice of investment options is a plan administrator function and not a plan sponsor function. The plan will typically say that the investment options are chosen, reviewed periodically, and added or replaced from time to time, by the plan administrator. It is typical to have one or more fixed income options, a variety of equity options ranging from large capitalization companies to small capitalization companies, from growth companies to "value" companies, and from U.S. to global/international companies. Sometimes plans will offer both actively managed options and passive or index options in some of these categories. Most plans will now have a series of target date funds (TDFs) - more on this below. Finally, publicly traded companies sometimes offer their stock (usually in the form of an employer stock fund) as an investment option - this choice is generally made by the plan sponsor rather than the plan administrator, by having a provision in the plan document requiring that such option be included rather than leaving it up to the plan administrator.

5. Carrying out the plan administrator's duties - the periodic meeting

a. General

While the plan administrator has day-to-day duties - determining whether an employee has met the eligibility requirements for getting into the plan, determining when a benefit is due and payable, and addressing the kinds of operational mistakes that almost always crop up and need to be corrected - this guide is going to focus instead on the duties that can and must be carried out by having periodic meetings. The TPA who is hired to run the plan expects that there will be periodic meetings, and will even help the plan administrator to run them, but the duties set forth in this guide are ultimately those of the plan administrator, and must be treated seriously.

b. How often to have a periodic meeting

We think there should be at least semi-annual meetings, even for a small plan. Many larger companies have quarterly meetings. The very largest companies often have multiple committees involved with different aspects of plan administration with each committee operating on its own meeting schedules. The specifics of that are beyond the scope of this guide, which will assume that there is a single entity that has semi-annual or quarterly meetings.

c. Who gets invited to the periodic meeting

It is typical to invite the TPA to the periodic meeting. The TPA can help the plan administrator address timely topics. In addition, the TPA can often provide an investment review for the plan administrator – for example showing performance over 1, 3, 5 and 10 years, and comparing that performance to a benchmark. Some plan administrators retain an independent fiduciary to advise it, in addition to, or instead of, the TPA. In that case, the TPA should, of course, be at the meeting. But since one purpose of the meeting should be to review the performance of third parties (including the TPA), there should be a portion of each meeting to which those third parties are not invited. Finally, many plan administrators choose to invite legal counsel to their meetings.

d. Keeping minutes

The first task at a meeting is to review the minutes of the prior meeting, to ensure continuity from meeting to meeting. This, of course, assumes that written minutes are being prepared, and it is essential that this is happening. The minutes for a meeting should show who attended, list the general topics covered and document the decisions that were made at the meeting. They need not go into great detail, and often it is better if they do not do so.

e. Review of investment policy

Every plan should have a written investment policy statement. A 401(k) or 403(b) plan's investment policy can be quite simple, just reflecting the requirements under Section 404(c) of ERISA for a self-directed plan. The policy should also indicate that the investment options' performance will be reviewed periodically against their respective benchmarks. Excessive detail should generally be avoided, since it can increase the possibility of a failure to follow internally generated rules. The policy should be reviewed periodically, but typically will not be changed, and, therefore, this item will not take more than a few minutes. The TPA, or the independent fiduciary, if one is retained, may recommend changes to the investment policy, as needed, to conform the policy to the TPA's or independent fiduciary's processes.

f. Review of investment performance

At the meeting, each investment should be reviewed in accordance with the investment policy to see how it performed against others in its peer group. The TPA (or independent fiduciary) will typically provide this information in advance so that the plan administrator can review it before the meeting and the meeting can proceed efficiently.

If investments are performing within the required parameters, no action is needed. If they are underperforming, the plan administrator will have to take note of that fact, and determine whether the underperformance is serious enough and of long enough duration to warrant removing the investment from the options offered and replacing it, if appropriate. Sometimes the plan administrator will put an investment on a watch list or indicate that its performance, and any pertinent information relating to the fund's performance or operations, should be reviewed with particular care at the next meeting. It is not expected that investment options will be changed frequently. That is why investment policies typically look at longer performance - 3, 5 or 10 years - rather than current performance. Of course, an investment option should be removed if it is no longer appropriate or if its long-term investment performance consistently lags its peers or its benchmark, but the plan administrator should understand that this is a potentially disruptive process that will need attention and require additional plan administrator work to make sure the change is communicated appropriately to participants and effectuated properly.

At this portion of the meeting, the plan administrator typically gets a lot of help - from the TPA, or from the independent fiduciary if there is one. One error we sometimes see is for plan administrators to spend too much time on this review, and too little time on the review of fund costs - the next two topics (g and h below). It is generally the cost review, or the lack of adequate cost review, that has been the focus of current litigation, rather than the underperformance of one investment option.

g. Review of expense ratios of investments

The Department of Labor has stressed the point that it is important to review the expense ratio of an investment fund choice separate and apart from its performance. (The expense ratio is the percentage of an investment's value that is expended for the management of the investment option and reduces the gross return.) Articles in the mainstream media, and the pleadings filed in different lawsuits, stress the same point. Therefore, time should be taken at each meeting to review the expense ratio of a particular investment to see if it is high in comparison to like investments. Sometimes the same investment will have a different "share class" with a lower expense ratio, so it is always a good idea to ask f there is a lower share class that is available to the plan.

In general, expense ratios of investments should be kept as low as is reasonable under the circumstances, since high expense ratios are a target for litigation. Of course, each situation must be judged on its own facts. But if, for example, the reason for a plan administrator not moving to a lower cost investment is that it will not produce enough "revenue sharing" to cover the plan's administration fees, this should highlight the need for a more careful review. See h below.

One issue that is often reviewed at periodic meetings is whether, in each category of investment, there should be an option to invest in a passive (or index) fund, which will almost always have a lower expense ratio than an actively managed fund. The debate of active versus passive investing continues, and, as lawyers, we simply observe that the issue should be addressed and reflected in the minutes, regardless of the decision.

h. Review of reasonableness of fees to third parties and how they are paid

As we have noted, policing cost is perhaps the most important task of the plan administrator at the periodic meeting - both expense ratios, discussed in g above, and the cost of record keepers and fiduciaries, if paid by the plan directly or indirectly. For one thing, the failure to police cost currently appears to be the most common basis for litigation against plan administrators. In addition, the Department of Labor in its regulations has made it clear that controlling cost and communicating cost information to plan participants are fiduciary responsibilities.

The TPA is required by law to disclose to the plan administrator how much it is getting paid and where the dollars are coming from. (This is sometimes referred to as the ERISA 408(b)(2) disclosure.) It is very common for the fees to be paid by the plan, either directly (by reducing each participant's account balance) or indirectly from plan assets (by having a payment that is made from individual investments credited by the TPA as payment of its administration fees). These indirect payments from individual investments are commonly referred to as "revenue sharing."

The mechanics by which third parties are paid from amounts generated by individual plan investments is a complicated issue, but it is a critical issue about which plan administrators must educate themselves. The failure to understand the flow of funds that results in payment to third parties can be the basis of an accusation in a lawsuit of breach of fiduciary duty.

In addition to understanding the flow of funds, the plan administrator must assure itself that the resulting fee is reasonable. To reach this conclusion, the plan administrator must periodically benchmark the fee against the fees charged to other plans by the same third party and by competitive third parties. This benchmarking is best done by an outside service that offers benchmarking services, and a number of options are available to the plan administrator.

i. Review of default option (typically a target date fund (TDF))

Most plans will have a default investment, and in most cases target date funds (TDFs) will be chosen as the default investment. Because TDFs are becoming a dominant investment choice, they should be given particular attention at the periodic meeting.

The Department of Labor, in a 2013 publication on TDFs, made it clear that TDFs cannot simply be treated like other investments, where reviewing expense ratios and investment performance will suffice. Some of the special factors noted by the Department of Labor are: a. the mix of investments at any particular age, which may vary from TDF to TDF; b. the “glide path” - how the mix changes as a participant ages up to and through retirement; c. the fee structure; and d. whether only proprietary funds are used in the TDF – for example, Fidelity’s Freedom Funds use all Fidelity investments – or whether non-proprietary investments are also used. We would add to that the question of whether to use a TDF with only passive investments vs. one that uses only actively managed investments or a combination of passive and active. This full analysis need not be performed at every meeting, but should be performed initially and then updated periodically.

j. Review of managed accounts

Many TPAs and independent fiduciaries now suggest that, in addition to providing participants with a TDF and an array of investments where participants can “self-direct”, a plan administrator should consider offering a middle ground, where a participant can pay for an outside investment manager to design an investment strategy for that participant’s needs from the array of investments provided under the plan. This middle ground is commonly referred to as a “managed account.” Financial Engines has traditionally been the dominant company offering this service, either directly or through a TPA. In any event, a TPA will interface with Financial Engines to provide this option if the plan sponsor chooses. The cost of the option will typically be paid from the participant’s account. As an alternative, Fidelity Investments offers its own product, called PAS-W, to plans that use Fidelity as the TPA. Additional outside managers exist for managed accounts, and this area is likely to see greater competition in the future.

k. Review of stable value options

Many plans offer what is known as a stable value option for participants who want a fixed income investment that is unlikely to lose value under any circumstances. While money market funds serve this purpose, when interest rates remain low as they have for the past several years, money market funds sacrifice almost any chance of growth. Stable value funds that are designed exclusively for 401(k) or 403(b) plans are offered by insurance companies and investment companies - they generally offer higher returns than money market funds while guaranteeing that principal will not be lost. But they are complex investment products, and if a plan administrator chooses to offer one, it should understand how it works. In the alternative, if a plan administrator decides not to offer a stable value option, and instead offers only a money market fund, it should be prepared to explain why.

l. Review of brokerage window option

Some plans offer participants the option of establishing an individual brokerage account within the plan and investing their plan accounts as they wish within that account instead of using the investment fund lineup offered generally. This feature is typically offered by the TPA, and the exact rules - whether the entire plan account can be invested in this way or only a portion, and whether there are any restrictions on the type of assets that can be bought within the brokerage account- will vary. It generally will be the plan administrator's decision whether to offer this feature, and if it does, the plan administrator should understand how it works and how many participants are taking advantage of it.

m. Review of data security

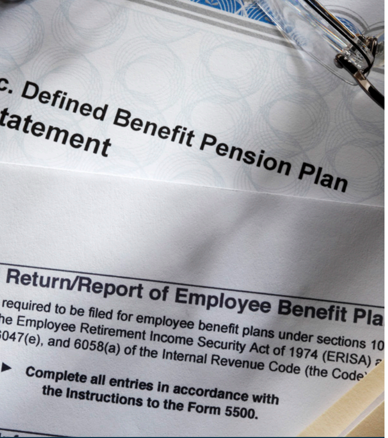
Your TPA is probably spending a great deal of effort to protect your plan's data from cyber crimes. While you must rely on the expertise of these third parties, you should make inquiry as to their efforts, and determine whether there are any further safeguards they can offer to you to make data more secure. This does not necessarily have to be a topic at every meeting, but it should be raised periodically.

n. How to allocate time at a periodic meeting

The above list is intimidatingly long, and since most periodic meetings are scheduled to last not more than a few hours, it can be difficult to fit everything in. Our most important piece of advice is NOT to spend the bulk of your time on periodic investment performance. While this is undeniably important, it is not more important than fee and cost issues and the suitability of the TDFs and managed accounts being offered. If you have 2 or 4 meetings a year, you might consider highlighting different topics at each meeting so that all of the above issues are addressed over the course of a year.

6. The Department of Labor's 2017 fiduciary rules - do they change the role of the plan administrator?

In April 2017, new fiduciary regulations promulgated by the Department of Labor go into effect. These rules have been many years in the making, and are controversial. In a nutshell, some of the guidance offered to participants that previously was not "fiduciary conduct" now will be fiduciary conduct. This means that the person offering it will be held to the higher standard of conduct that applies to fiduciaries.



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For a 401(k) or 403(b) plan administrator, some of the areas that will be impacted by this rule change are:

i. At the plan administrator level, some of the informal advice offered by the TPA to the plan administrator as to choosing funds may be fiduciary advice, holding the TPA to a higher standard.

ii. At the participant level, the advice given by a TPA to a participant who calls or goes on line will be fiduciary advice.

iii. Also at the participant level, the guidance given to a terminated participant as to whether and where to roll over an account balance, as opposed to keeping it in the plan, will be fiduciary advice, and the party giving that guidance will be held to a higher standard.

You will note that the party being held to a higher standard is not the plan administrator, but rather the TPA. But this will still put a greater burden on the plan administrator. First, it is likely that by the end of 2016 or in early 2017, the plan administrator will be presented with modifications to service contracts to reflect these changes. These modifications should be carefully reviewed. Second, because the TPA will now be engaging in fiduciary conduct, the plan administrator has some duty, as a co-fiduciary under ERISA, to monitor the TPA's fiduciary conduct. This may involve, for example, reviewing for correctness the "scripts" that will be used by the TPA in giving rollover advice.

Questions or Assistance:

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