

THE SHERIDAN ROAD MAP



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MAJORITY OF EMPLOYEES HAVE FINANCIAL STRESS

Eighty-six percent of employees surveyed by Financial Finesse said they have at least some financial stress.

The survey found financial stress is heavily correlated with poor money management skills; however, those who report no financial stress and are doing a good job managing their day-to-day expenses, debts, and emergency savings accounts, are surprisingly lax about longer-term financial planning priorities, such as retirement planning. Sixty-seven percent of those who report having no financial stress indicate that they are not prepared for retirement, and less than half have drafted basic estate planning documents like wills and trusts to protect their assets.

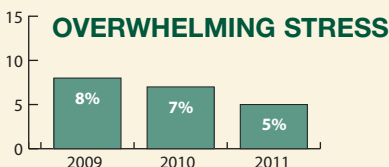
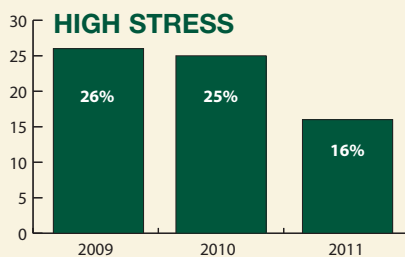
The key demographic groups most vulnerable to having financial stress are women (90% report having financial stress), employees ages 30-44 (89%), and middle-income Americans making between \$60,000 and \$74,999 per year (94%).

Married employees (85%) reported less stress than single employees (87%).

The full survey report can be found online at: <http://www.financialfinesse.com/wp-content/uploads/2011/05/2011-Financial-Stress-Research.pdf>

Key Trends

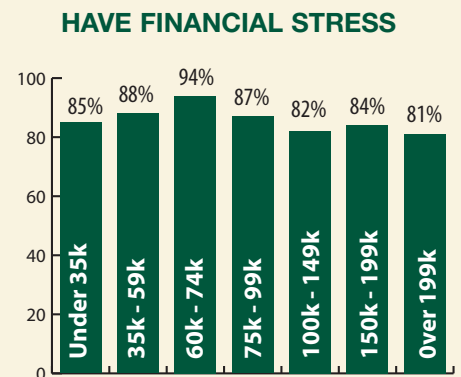
Employee financial stress has decreased to more manageable levels.



Women are three times as likely as men to face overwhelming financial stress.



Middle-income employees are under more financial stress than low- or high-income employees.



DOCUMENTING THE DECISION-MAKING PROCESS

Decision issued in *Gerald George vs. Kraft Foods Global, Incorporated* suit.

In the last few years, ERISA fiduciaries and plan sponsors have been targeted by numerous participant lawsuits, usually based on investments in employer stock or plan fees, with mixed results. On April 11, 2011, the Seventh Circuit Court of Appeals issued a decision that addresses both issues. While the decision does little to provide certainty for plan fiduciaries, it does reinforce the point of several recent columns—the importance of documenting the fiduciary decision-making process.

ABOUT THE LAWSUIT

In *Gerald George v. Kraft Foods Global, Incorporated*, participants in the Kraft 401(k) plan sued the plan sponsor and other fiduciaries alleging that they imprudently allowed the plan to generate insufficient returns on investments in employer stock and incur excessive fees for recordkeeping services. Specifically, the lawsuit was based on facts related to the use of a unitized employer stock fund, the service provider selection process, and the custodian's retention of "float" on plan assets.

Like many plans with an employer stock investment option, the Kraft plan permitted participants to invest in Kraft stock by purchasing units of the employer stock investment fund rather than shares of stock. A small portion of the unitized stock fund was held in cash in order to facilitate the processing of changes in participant investment elections or plan distributions without requiring the sale of stock on the open market. The plaintiffs argued that the fund's investment in cash resulted in reduced returns when Kraft stock increased in value, as it did during the period in question. They also argued that the pro rata allocation of transaction costs among all fund participants provided an incentive for participants to increase their trade activity, resulting in greater transaction fees and reduced investment returns for the fund as a whole. The suit alleged that the plan's fiduciaries breached their duties by failing to take actions to minimize these consequences of unitization.

THE DECISION

The district court granted summary judgement dismissing the plaintiff's claim after determining that the Kraft fiduciaries weighed the costs and benefits of implementing changes to the unitization system and concluded that the costs outweighed the changes. While there was evidence that the fiduciaries had discussed these issues, the Court of Appeals stated that it could find "nothing in the record indicating that the defendants ever made a decision on these matters—i.e., that they actually

determined whether the cost of making changes to the CSE, outweighed the benefits, or vice versa." Based on this finding, it reversed the summary judgement and remanded the case to the district court to make a determination as to whether the fiduciaries made an affirmative decision to continue unitization after considering the issues.

The excessive fee claim was based on the fact that the fiduciaries had retained the same recordkeeper for the plan since 1995

without soliciting bids from competing recordkeepers. Instead of soliciting competing bids, the plan fiduciaries relied on the recommendations of consultants as to the reasonableness of the existing recordkeeper's fees. The district court determined that relying on the advice of consultants satisfied the duty of prudence and granted summary judgement for the fiduciaries. On appeal the Seventh Circuit held that, while engaging consultants and relying on their advice was evidence of prudence, it was not sufficient to entitle the fiduciaries to judgement as a matter of course. It stated

that, depending on the facts, a trial court could reasonably conclude that the defendants did not satisfy their duty to ensure that the recordkeeper's fees were reasonable. The summary judgement was reversed and remanded to the district court for further proceedings.

On the third claim, the Court of Appeals affirmed that district court's grant of summary judgement on the issue of float income on benefit payments. The plaintiffs alleged that the fiduciaries breached their duties by failing to determine how much float income the trustees was earning. They argued that the fiduciaries could not determine if the trustee's overall fees were reasonable without knowing how much float income was generated by the plan's assets. The plan's fiduciaries were able to show that they received annual reports on the amount of float income and the district court's decision was upheld.

It is important to note that the Seventh Circuit did *not* hold that the Kraft plan fiduciaries breached their fiduciary duty. Instead it held that with respect to the unitization and fees claims, the record did not support an automatic conclusion that the fiduciaries acted prudently and sent the cases back to the district court for additional findings of fact. In contrast, where the fiduciaries could document that they knew the annual value of the float received by the trustee, it upheld the decision in their favor. After additional proceedings at the district court level, it is quite possible that the plan fiduciaries will prevail with respect to both unitization and fees.

One of the main themes of fiduciary risk management—documenting the decision-making process.

THE BRAVE NEW WORLD OF THE 403(B) OVERSIGHT COMMITTEE

Three years ago, many people predicted that the 403(b) industry would change overnight as a result of new regulations that had passed.

Those regulations required plan sponsors to maintain a written plan document, adhere to specific audit requirements for plans with more than 100 participants, and adopt a new focus on fiduciary governance. Those that expected change were correct, but the change took longer than many experts originally thought.

To take this a step further, while many experts predicted the adoption of a written plan document would spur nonprofit plan sponsors to form oversight committees, review fees, and initiate changes to fund lineups and recordkeepers. In actuality, it was the audit process that has taken a more central role in motivating a 403(b) sponsor to initiate much of this work.

In establishing appropriate oversight, plan sponsors have charged Audit Committees, typically composed of outside trustees, with the task of serving as fiduciaries to these plans. Interestingly, many of these committee members/trustees come from the corporate world where they are familiar with the comparable 401(k) plan and understand the implications of acting as an ERISA fiduciary.

As a response to the long list of fiduciary responsibilities that Audit Committees are now charged with, committees in many cases are turning to internal management at their respective non-profits to form dedicated 403(b) oversight committees. These subcommittees are put in place to formalize governance, review recordkeeping vendors to assess plan structure and investments, and to analyze fee & revenue arrangements that are embedded within plans.

The progression of events detailed above, from the release of 403(b) regulations in 2007 to today, have spawned several best practices in the industry. In most cases, these best practices were first adopted in the private sector, as a part of 401(k) oversight. For 403(b) plan sponsors, many are finding that by understanding and adopting a 401(k) approach to their plan, they not only mitigate much of the fiduciary risk they have assumed, but they also build better plans for their participants.

BEST PRACTICES IN THE 403(B) OVERSIGHT PROCESS

The following is a brief overview of some of those best practices that plan sponsors are incorporating into the 403(b) oversight process:

- **Adopting a committee charter/investment policy statement:** The committee charter codifies who is on the committee, the roles and responsibilities of the committee, and the process

by which the committee will vote on items that are under its oversight. The IPS helps to document the process by which investments are made and monitored, and clearly defines the roles and responsibilities of those involved in investment oversight.

- **Understanding investment arrangements:** It is important that committees understand the contractual relationship the plan has with the recordkeeper, any third party administrator (TPA), and any investment options offered to participants. From an investment standpoint, many 403(b) platforms offer investment options that may be structured as separate contracts between the individual participant and the investment provider. Many may take the

form of individual annuity contracts. It is critical for the committee to thoroughly understand the terms of these contracts. The question of who has the authority to initiate the movement of plan assets should be examined as well. Moreover, liquidity provisions at the participant level may vary in many of these contracts and should be fully understood also.

- **Reducing the number of investment funds in the plan:** As ERISA fiduciaries, the committee is tasked with performing due diligence on investment options and making sure they are competitive from a fee and performance standpoint. On an ongoing basis, the committee is responsible for monitoring all funds to ensure that they continue to be viable options. Too many fund options creates a cumbersome monitoring process and one that is susceptible to risk. A long list of investment options can also cause participant confusion and



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DOCUMENTING THE DECISION-MAKING PROCESS *(continued from page 2)*



CONCLUSION

Because of the nature of the holding, the *Kraft* opinion does not provide substantive guidance on what constitutes prudence with respect to a unitized stock fund or recordkeeping fees. However, it seems to indicate that if the Kraft fiduciaries had provided sufficient client documentation of their decisions and actions on all three claims, instead of just on float income, the Court of Appeals would have upheld the district court's initial decision and the time and expense of additional court proceedings would have been avoided. This clearly reinforces one of the main themes of fiduciary risk management—documenting the decision-making process. In order to prevail over a charge that it breached its duties, an ERISA fiduciary must be able to provide evidence of how it made a decision, the fact that it affirmatively made a decision, and the reasons for the decision it made.

By Ian Kopelman • Defined Contribution Insights, May/June 2011

THE BRAVE NEW WORLD OF THE 403(B) OVERSIGHT COMMITTEE *(continued from page 3)*

reduce participation in the plan due to choice overload, the outcome of which is participants deferring (or putting off entirely) their investment decisions. We recently worked with a higher education client in which we helped narrow the number of funds from over 200 options to approximately 20, a number that is more in line with the average 401(k) plan.

- **Evaluating Single vs. Multiple Vendor Arrangements:** Another difference between 401(k) plans and 403(b) plans is the issue of single versus multiple recordkeepers. It is very common in 403(b) plans to have multiple recordkeepers and investment providers. This is rarely, if ever, seen in the 401(k) arena. Committees must weigh the benefits of a multiple vendor arrangement versus its weaknesses. The potential for increased audit fees, participant confusion and more challenging administration need to be considered.
- **Assessing investment and plan fees:** Fees are a critical component of a successful retirement program. They are, arguably, more opaque in 403(b) plans than 401(k)'s due to the aforementioned prevalence of individual annuity contracts. Plan sponsors are held to the standard of a prudent expert under ERISA. If they cannot document reasonableness of fees, through a process of benchmarking, they are not fulfilling their fiduciary duties.

These are just a few of the important items that newly formed committees must consider. Due to the somewhat daunting task of carrying out these responsibilities alone, many plan sponsors find solace in turning to outside experts to help them navigate the process. It is tough to argue that a committee working alone to fulfill its fiduciary roles would have an easy road ahead of it.

NOTE: This feature is to provide general information only, does not constitute legal advice, and cannot be used or substituted for legal or tax advice.

By Jeff Capone • PLANSPONSOR.com, April 2011



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