

FIDUCIARY BEST PRACTICES FOR DEFINED CONTRIBUTION PLAN SPONSORS

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AGENDA

Review of Fiduciary Concepts

Fiduciary Investment Considerations

Governance Best Practices for Plan Fiduciaries



KEY FIDUCIARY CONCEPTS

- Prudence - “Prudent Expert Standard” - To use the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims
- Loyalty - To act solely for the benefit of the participants and beneficiaries
- Follow the plan documents - Plan Document, trust agreement, Investment Policy, and other applicable documents
- Diversify plan investments
- Pay only reasonable plan expenses

WHO IS A FIDUCIARY?

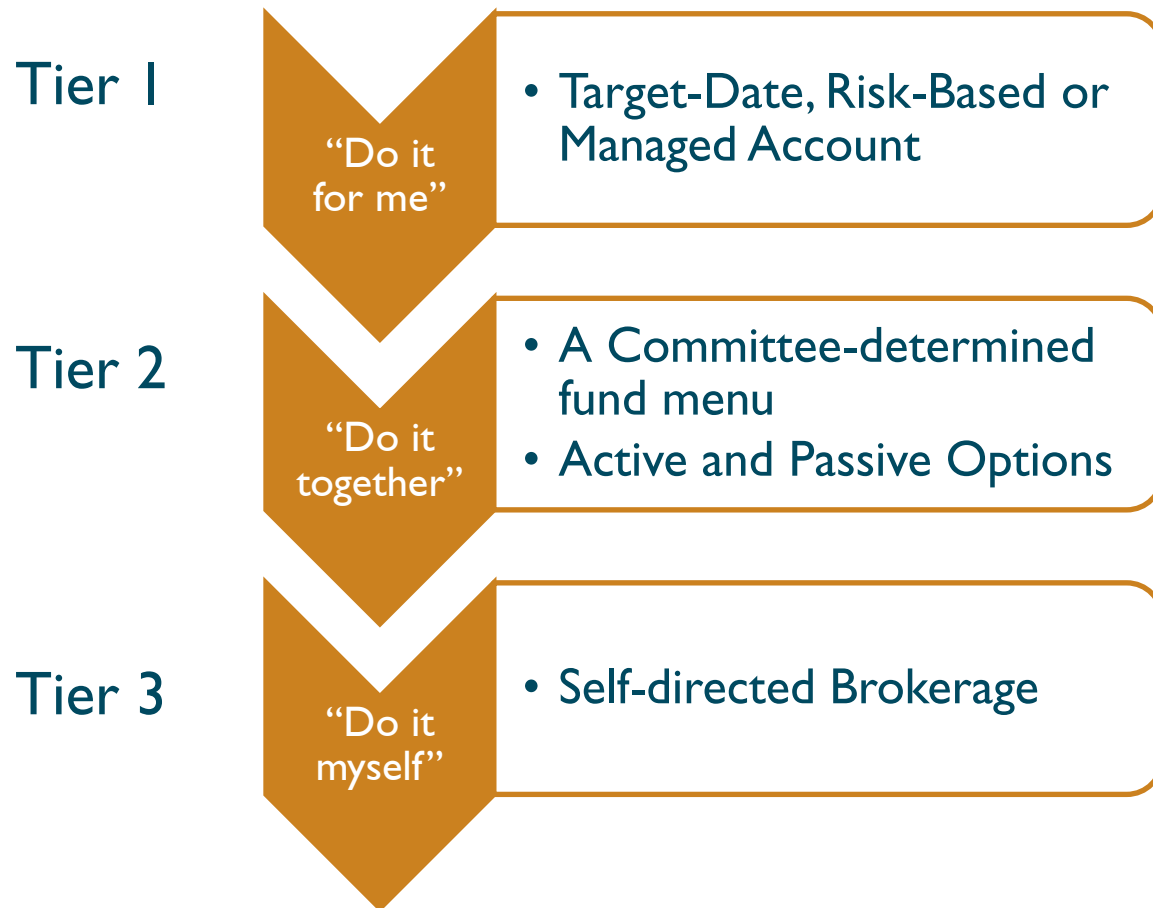
- Many of the actions involved in operating a plan make the person or entity performing them a fiduciary
- Fiduciary status is based on the *functions performed for the plan, not just a person's title*. Attorneys, accountants and actuaries generally are not fiduciaries when acting solely in their professional capacities
- A plan's fiduciaries will ordinarily include the trustee, investment advisers, and all individuals exercising discretion in the administration of the plan. The key to determining whether an individual or an entity is a fiduciary is whether they are exercising **discretion or control over the plan**

PLAN MONITORING

- Performance Standards – Outcome or Process Based?
- Procedural Prudence Defined
 - Giving appropriate consideration to those facts and circumstances that, the fiduciary knows or should know, are relevant to the particular investment or action involved
 - Acting accordingly

THREE TIERS OF OFFERINGS TO PARTICIPANTS

For participants
who desire:



TIER 2: DO IT TOGETHER TYPES

Asset Class	Fund Menu		
Cash, Stable Value, and Low Duration	• Money Market or Stable Value	• Low Duration ²	
Fixed Income	• Indexed Core U.S.	• Active Intermediate Term Fund	
Real Return	• Diversified Real Return		
Large Cap	• Active Value	• Indexed Blend	• Active Growth
Small / Mid Cap	• Active Value	• Indexed Blend	• Active Growth
International	• Active Value	• Indexed Blend	• Active Growth

(2) Low duration may be omitted if stable value is used.

- Fund count: 13-15
- Or, 16-18 if separate Small and Mid Cap funds are required

INVESTMENT PERFORMANCE REVIEW

- Peer group comparisons
- Index benchmark comparison

Example:

Large Cap Core Manager:

- Peer group: Large Cap mutual fund peer group
 - Index benchmark: S&P 500 Index benchmark
 - Consultant to have reviewed second level diagnostics
- Performance meets expectations: Pass
 - Performance below expectations: Analyze / diagnose

PEER GROUP RANKINGS – ACTIONABLE OR INFORMATIONAL?

•Top Quartile Manager
Analysis by Dimeo Schneider
(as of 12/31/09)

Category	Percent of 10-Yr Top Quartile Funds Below Median for a 3 Yr Period	Median Consecutive Yrs Spent Below Median	Percent of 10 Yr- Top Quartile Funds Below Median for a 5 Yr Period
Intermediate Bond	88%	1.00	64%
High Yield Bond	91%	1.50	73%
International Bond	92%	1.00	50%
Large Cap Value	96%	1.75	74%
Large Cap Core	81%	1.00	61%
Large Cap Growth	84%	1.25	60%
Mid Cap Value	100%	0.75	67%
Mid Cap Core	85%	1.38	75%
Mid Cap Growth	83%	1.25	66%
Small Cap Value	93%	2.00	57%
Small Cap Core	76%	1.00	41%
Small Cap Growth	86%	1.50	74%
Real Estate	82%	1.00	36%
International Value	93%	0.75	50%
International Core	67%	0.25	33%
International Growth	100%	1.25	89%
Emerging Markets	93%	1.13	64%
TOTAL	85%	1.13	62%

RELEVANT DIAGNOSTIC INFORMATION

- **Long-term Performance vs. Short-term Performance**
 - Chronic / Severe or Passing / Mild Condition
- **Performance Consistency Measures**
 - Yearly Performance
 - Manager Batting Average vs. Index
- **Long-term Relationships Between Risk and Return**
 - Sharpe Ratio – Return Per Unit of Risk
 - Standard Deviation and Beta – Risk Relative to Return Pattern and Benchmark
- **Investment Portfolio and Style Issues**
 - Security / Stock Concentration and Sector Concentration (Over- / Under-weights)
 - Stocks - Growth vs. Value Styles
 - Bonds - Sector Allocations (Government, Corporate, Mortgages, etc.)
 - Bonds - Interest Rate Risk / Duration
- **Management Team Tenure / Turnover / Consistency**
- **Investment Expense**

ALLOCATING GOVERNANCE RESPONSIBILITIES

TASK	INVESTMENT COMMITTEE	STAFF	INVESTMENT CONSULTANT
Investment Policy Draft	Final review and approval – delegate draft to others	Preliminary Review and Edit	Draft document for review with Staff and Committee
Investment Reporting	Review	Review & process facilitation	Preparation of information & analysis
Investment Performance Assessment	Primary decision making	Process facilitation	Presentation of information & analysis
Investment Research & Analysis	Delegate to investment Consultant	Process facilitation	Perform research and analysis and present results and recommendations
Investment Manager Watch Status Determination	Final decision-making authority	Input and comment / facilitate process	Input and recommendation for decision
Investment Manager Termination or Selection	Final decision-making authority	Input and comment / facilitate process	Input and recommendation for decision

FIDUCIARY BEST PRACTICES – AREAS OF CAUTION

- **Potential Breaches**
 - Failure to fulfill prudent expert standard
 - Failure to monitor or act
 - Prohibited transactions (excise/penalty taxes)
- **Documentation and Maintenance of Good Records**
 - Policies
 - Minutes of actions and decisions
 - Supporting documents and data
- **Indemnification**
- **Delegation and Monitoring of Responsibilities and Functions**

INVESTMENT POLICY FAQ'S

- Is an Investment Policy required by ERISA?
- Should a sponsor maintain an Investment Policy?
 - How can it help fiduciaries fulfill their responsibilities?
 - Why would one Investment Policy differ from another?
 - Can the Investment Policy Statement hurt the fiduciary cause?

COMPONENTS OF AN INVESTMENT POLICY STATEMENT – INVESTMENT OR LEGAL MATTER?

■ **Investment Policy Content**

- Introduction and purpose
- Responsibilities
- Committee process
- Investment criteria and benchmarks
- Investment selection and monitoring

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