Center for Due Diligence
Information & Strategic Resources for the Retirement Plans Industry

EVALUATING RETIREMENT PLAN ADVISORS:

A Dynamic Guide To Help Plan Sponsors Fulfill Their Fiduciary Duty & Avoid Liability

by
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"If you can't describe what you are doing as a process, you don't know what you're doing"

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INTRODUCTION: By Marcia S. Wagner, Esq

Retirement plan vendors entice plan sponsors with a wide array of supposedly necessary services that are allegedly required for the day-to-day operation of their plan and the fulfillment of fiduciary duties. Sponsors may be aware of ERISA's basic duty requiring them to discharge their responsibilities solely in the interest of plan participants and beneficiaries, but it is no easy matter to determine if the bundled services are needed to meet this requirement. Identifying the party or parties who will deliver them in the most efficient and cost-effective manner is equally as challenging. Such services may include assistance in determining a plan's investment objectives, selecting investments or non-investment service providers, monitoring performance, evaluating & benchmarking the reasonableness of plan expenses and assessing communication strategies.

Government agencies, such as the Department of Labor, have attempted to help plan sponsors by offering "tips" in the form of questions that can be asked of plan service providers. The tips are intended to objectively assess the quality of the services offered and the reasonableness of fees charged in light of the services provided. In addition, the process is supposed to ferret out self-dealing, conflicts of interest and other improper influences, as well as the advisor's experience and willingness to accept a fiduciary role. But, as yet, there has been no comprehensive tool to achieve the goal of fully evaluating an advisor.

The Center for Due Diligence's guide, "Evaluating Retirement Plan Advisors," is an important development. The guide, along with its companion, the ERISA Advisor Evaluator, should **provide an objective mechanism for separating true ERISA experts from well-meaning generalists who might otherwise lead a plan into trouble.** The guide complements an evaluation that may rest solely on the basis of a personal relationship with quantitative measurements of the quality and value of the services being delivered. Further, it facilitates the benchmarking of these measurements.

Plan fiduciaries are judged not on the results that they achieve, but on the processes they follow. Such processes have evolved over time. One of the key features of the guide is the place it reserves for the frequent updating of standards and its recognition that the phrase, "once and done," is not something that can be applied in the ERISA context.

The CFDD's companion to the guide, the ERISA Advisor Evaluator, is an online service that allows advisor candidates to provide responses to standardized questions in an RFP format so that plan sponsors can compare apples to apples in reviewing the services that they are buying. While facilitating such comparisons, the ERISA Advisor Evaluator also accommodates customized questions and will, therefore, be useful for plans of all types and sizes.

ERISA can be a field of great complexity. The trend of providing employers with a go-to expert who can advise plan sponsors on a multitude of service provider issues can be seen in regulatory and legislative reform efforts. And yet, this most important intermediary must be selected and monitored with the utmost of care. The CFDD's new guide provides a means of fulfilling this essential duty.

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About the Author

Phillip Chiricotti is the Founder & President of the Center for Due Diligence (CFDD), independent information and strategic services firm serving the retirement plans industry. Mr. Chiricotti has almost four decades of experience in the financial services industry, including extensive ERISA plan consulting.

Harnessing an unmatched network of accomplished contributors, he has authored decades of highly respected research. He is often quoted, routinely listed as one of the most influential people in the industry and widely recognized as a top business development consultant.

Whether addressing executives or intermediaries, he uses his pen as a sword, brings keen analytical insight to the industry and delivers it in a no nonsense fashion guaranteed to provoke intellectual thought.

Prior to entering the financial services industry, Mr. Chiricotti worked in strategic planning, acquisitions and other financial areas for some of the nation's largest companies, including major banks, pharmaceutical companies and oil producers.

About the CFDD

Formerly the premier provider of 401(k) program competitive analysis, the **CFDD** is now focused on providing unbiased resources, industry leading conferences and ERISA Advisor Evaluation services. Other than the EAE's vetting process, **the CFDD does not sell any financial products or services.**

Since its inception in 1993, the CFDD has been 100% focused on providing retirement plan advisors with unbiased information and guidance. As a bottom up, advisor-centric, networking organization, the CFDD is widely viewed as the King of Content.

The CFDD's Advisor Conference is recognized as the premier educational and networking event for the retirement plan advisory industry. As the only conference that focuses exclusively on practice management, practical product applications and helping advisors grow their business, more accomplished retirement plan advisors attend the CFDD's Advisor Conference than any other industry event.

Consistent with the need for growth and risk management, **the CFDD is committed to turning the industry into a profession, helping "expert" retirement plan advisors partner with plan sponsors and mitigating plan sponsor risk through a prudent process for advisor selection.**

About the Guide & The EAE Program

Prior to the development of the CFDD's Guide on "Evaluating Retirement Plan Advisors" and the EAE Program, there was little guidance available to assist sponsors with the advisor evaluation process. While the industry's marketing departments have provided literature on the perceived value of an independent advisor, the material was often designed to sell product.

To help plan sponsors fulfill their fiduciary duty to plan participants and their beneficiaries, "Evaluating Retirement Plan Advisors" was designed to be **a practical guide on how to evaluate ERISA plan advisors.**

The guide includes **suggested criteria for the evaluation of retirement plan advisors and as well as detailed background information designed to help plan sponsors understand the criteria.** This research was not designed as a guide on how to conduct an RFP search. However, as a companion service, **the online EAE will provide the RFP and the detailed questions needed to complete a successful ERISA plan advisor search.**

Given the rapidly evolving environment, this guide will be updated frequently to stay current with changing industry conditions, regulatory reform and the appropriate criteria for advisor evaluation.

The EAE Program

As noted, the "Evaluating Retirement Plan Advisors" guide was designed to be used in conjunction with the ERISA Advisor Evaluator (EAE) Program.

The EAE is **an independent online RFP service designed to help plan sponsors find, identify, contrast and evaluate retirement plan advisors who meet the CFDD's minimum standards**. While the minimum standards are based on extensive research and network feedback, each sponsor will determine their own advisor search criteria.

In addition to professionalizing the advisor search process, the unbiased, low cost, convenient and easy to use EAE will **increase plan sponsor efficiency, reduce their burden and provide risk mitigation by documenting a prudent process for the retention of advisory services.**

The Program is further distinguished by the fact that the EAE is **the ONLY service that imposes minimum standards to participate and provides meaningful due diligence on retirement plan advisors, insurance policy/bonding reviews and optional advisor background checks.**

While ERISA does not require advisors to maintain E&O insurance coverage for fiduciary services provided to ERISA plans, **sponsors must ensure their outside vendors have the proper coverage.** Unfortunately, the only way to determine if the coverage is adequate is to have an insurance specialist read the policy.

Even though ERISA 411 requires it, **very few plan sponsors perform background checks on their advisors.** Going beyond the limitations of self-reported information, the advisor background check includes professional licensing, regulatory issues, criminal/civil background, financial liens, judgments, bankruptcies and credit checks.

In short, ERISA plans have become a very specialized area and the EAE will **provide a painless, affordable and prudent process for plan sponsors to separate independent retirement plan experts from generalists.**

The online EAE service is designed for use with plans of all sizes and while it contains **standardized RFP questions vetted by industry experts**, plan sponsors will have the ability to add, delete, modify or customize their own questions. As the plans increase in size, the standardized questions will also become more detailed.

In addition to the RFP, the base sponsor service will include training & tutorial components, meaningful links and downloads. An optional consulting service will be available on a fee basis to assist sponsors with RFP development and management. To remain neutral, the optional consulting service will NOT include advisor evaluation. However, while less than 10% of the nation's financial intermediaries qualify, **advisors participating in the EAE program must meet minimum standards.**

Along with other information, **the advisor's profiling questionnaire will be used by plan sponsors for search, sorting and selection, i.e., determining who will participate in the RFP.** Once the RFP questionnaire is completed, the selected advisors will be contacted and given a fixed amount of time to populate the RFP using a web-hosted system.

Upon receipt of all data, sponsors may access **an automated scoring system that permits them to weight responses** based on their own preferences. Once the process is complete, sponsors may request additional information or download and forward the report to committee members.

In a mature market, consolidation and differentiation are the path to growth. Through increased advisor efficiency, activity and applying a fiduciary standard to the selection process, **the EAE will help expert retirement plan advisors participate in the consolidation of retirement plan advisory services.** The EAE will also facilitate more competitive programs for plan participants.

Plan participants pay most of the cost, assume all the risk and have little control over the plan or the investment menu. That is why ERISA requires plan sponsors to act solely in the best interests of participants. The role of an unbiased retirement plans expert is further reinforced by the fact that most 401(k) plans are small, relationship driven and lack a full time benefits person.

The EAE program and dedicated website are currently under development. For more information on the EAE program, advisors should go to: http://www.thecfdd.com/EAEprogram.

PREFACE

Few plan sponsors are fully cognizant of their retirement plan duties and personal liability under ERISA. Although **the law requires fiduciaries to implement a prudent process for evaluating, hiring and monitoring service providers, including advisors**, the duties are rarely prioritized or documented.

Given the reduction in corporate staff, increased liability and decline in sponsorship satisfaction, the advisor's role has never been more important. Sponsors have become increasingly knowledgeable about retirement plans, but **evaluating ERISA plan advisors remains a specialty within a specialty.**

Enormous attention has been focused on the importance of goals, expectations and on the hiring of investment managers, but **little attention has been devoted to the evaluation and monitoring of retirement plan advisors**, i.e., pension consultants.

While advisors are the gatekeepers to trillions of dollars of retirement plan assets and the security of millions of plan participants, **there is no formal process, law or rules for managing advisors.** Advisors are clearly important, but the sales driven retirement plan advisory business is laced with potential conflicts that have become the impetus for regulatory reform.

Retirement plan advisors provide a wide variety of services, including investment policy statements, money manager reviews, investment monitoring & reporting, program searches and much more. While plan sponsors can't eliminate their fiduciary responsibility, liability may be limited through the use of 404(c) and QDIA safe harbors. Additional protection may be available through the appointment of expert retirement plan advisors.

Selecting an expert retirement plans advisor is no small task. Like plan sponsors, advisors are often unaware of or ignore their fiduciary responsibilities under ERISA. **The majority of small plan sponsors and advisors also lack adequate first and third party insurance coverage**

.

In addition to lacking affirmative fiduciary coverage, **the majority of advisors servicing retirement plans are unwilling or unable to acknowledge fiduciary status under ERISA.** Some of the *Non-Fiduciary Advisors* will acknowledge their fiduciary status on a functional basis, but will not put it in writing.

The industry has often used the "fiduciary" term for marketing purposes and while a growing number of advisors will acknowledge non-discretionary *Limited-Scope 3(21) Fiduciary* status for investment advisory services, their contracts may be structured to limit liability.

A sub-set of advisors will accept additional liability for discretionary investment control as *3(38) Investment Managers* while others may be willing to accept an even broader named fiduciary type of role as a *Full-Scope 3(21) Fiduciary.*

Like any industry, advisor experience varies widely. Some of the advisors willing to accept fiduciary responsibility - including broader roles and more formal roles as investment managers - are fully qualified. Unfortunately, a far greater number are not.

PREFACE (continued)

While the fiduciary status of advisors remains unsettled, it is an important issue. In addition to being at the forefront of regulatory reform, **fiduciary status has a significant impact on retirement plans, sponsor liability, claims, conflicts and prohibited transactions, including self-dealing.**

Regardless of the advisor's fiduciary role and title, **sponsors must perform initial and ongoing due diligence to determine their qualifications as an "expert" and to avoid breaching their fiduciary responsibilities.** Due diligence is of paramount importance because trendy fiduciary titles and roles are increasingly being used for marketing purposes by advisors with little or no retirement plans experience.

Concepts like *independent* fiduciary and *expert* fiduciary have evolved over time. They are also mentioned in regulations and case law, but they are not formally defined in statute. In other words, **there are no specific or uniform applications befitting these labels.**

There are some extremely skilled and long tenured advisors serving the retirement plans market. On the other hand, **anyone can call themselves independent, an expert, a professional, a decision maker, a fiduciary, an ERISA fiduciary or any combination of the aforementioned**, including *Joe the Plumber.* There are simply no real requirements, i.e., education, designations, certifications, testing, licensing, training, insurance, indemnification, ongoing CE requirements, experience or any other vetting, applicable to those labels.

ERISA doesn't even impose requirements on 3(21) fiduciaries who function as investment advisors, but securities law requires them to be a SEC or state registered RIA to provide advice for a fee. The licensing required to dispense advice enables advisors to market their services, but it doesn't mean they are *qualified*, *competent* or *capable* of providing the services. Indeed, the SEC requires advisors to note on the cover page of the new ADV brochure that **being registered with the SEC does not imply the investment advisor possesses a certain level of skill or training.**

The need for advisor due diligence is further supported by the sharp jump in sponsor dissatisfaction with their advisors and broker-of-record turnover**.** In addition to not being prudent, **sponsors who replace generalists with other generalists are increasing, not reducing**, **their fiduciary risk.**

Regardless of any delegation or third party fiduciary roles, **sponsors remain responsible for prudently selecting and monitoring their advisors,** a task not to be taken lightly. The monitoring should include the advisor's performance, the investment performance under their control, plan compliance and ERISA compliance. Given that sponsors who delegate are still subject to co-fiduciary liability, the outsourcing does not eliminate the need for first party fiduciary liability insurance.

Given the maturity of the financial services industry, a formal process for identifying the advisor's role, defining the applicable standards of care/professionalism, the hiring process, the compensation methodology, disclosure, conflict safeguards, commission recapture and specific responsibility is long overdue.

PREFACE (continued)

Because companies and objectives vary, sponsors should **establish specific goals before the evaluation process is started.** While common goals include the lowering of costs, increased participation, improving returns and fiduciary insulation, smaller companies may be interested in increasing the benefits for the owners or key employees. If the goals change during the course of the evaluation process, each advisor should be re-evaluated as they change.

To enhance efficiency, the sponsor should identify and **communicate the exact scope of the engagement, company background, a plan overview and the minimum requirements for participation** to all candidates in advance of the process.

Advisors should be given adequate time to respond. Once the candidates have been selected and the process engages, **a standardized approach to advisor evaluation should be used to ensure fairness**.

To avoid stacking the deck, sponsors should **guard against attempts to skew the process** by parties of influence, a sadly routine occurrence.

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July, 2010

EXECUTIVE SUMMARY

The retirement plans market and the financial services industry have matured. Consistent with a maturing market, both are subject to increased liability, litigation, higher standards, extreme disclosure, regulatory overreach, fee pressure and intense competition.

Given that retirement plan sponsors are not in the investment or retirement plans business, **sponsors who manage their plans without the services of an independent expert shoulder a heavy burden and increased fiduciary liability.** The economic contraction and staff reductions have added to this burden.

Plan sponsors have been adding advisors to their plans for years. As a result, less than 20% of all plans are currently sold and serviced on a direct basis. Small plans make up the majority of all plans and 80% of those plans with an advisor are serviced by generalists. While small plan business is often channeled to existing relationships, **generalists are not in a position to add value.**

Fiduciary relationships are under intense scrutiny and it should be noted that **generalists may increase the sponsor's liability.** Unfortunately, small plan sponsors often purchase financial services from relatives, friends and business acquaintances, a fiduciary breach under ERISA with no defense.

As sponsors become more aware of their vulnerability, the majority of generalists will be replaced in the years ahead. Regardless of plan size, ERISA imposes a high standard of care and all fiduciary decisions have consequences. **Sponsors who can't prove the prudence of their decisions through a documented process, including those made with the best intentions, are now clearly in the plaintiffs' crosshairs.**

Expert retirement plan advisors are a positive catalyst for change, but until now, identifying unbiased retirement plan advisors has been difficult. Evaluating retirement plan advisors is a specialty area and with few exceptions, sponsors lack the information and background to ask the right questions, interpret the answers and make informed decisions.

To increase efficiency, sponsors should identify their needs, goals and the scope of the engagement before starting the search process. To ensure fairness and avoid conflict claims, a standardized approach should be used. Sponsors should also be aware of and guard against attempts to skew the decision making process. Given that chemistry generally plays a role, **the due diligence should be performed on a product, service, feature, individual or team rather than a sales presentation or personalities.**

The need for proper due diligence cannot be over emphasized because while RIAs may operate with a non-ERISA fiduciary standard, they also operate with limited regulatory oversight, no CE requirements, little if any net worth requirement and some states don't require any licensing. Independent RIAs may also lack professional liability insurance. Furthermore, consultants who are not RIAs or registered representatives affiliated with a broker-dealer may not be subject to ANY regulations, licensing or supervision.

Regardless of any delegation or third party fiduciary roles, sponsors remain responsible for selecting and monitoring their advisors on a periodic basis. While ERISA plans have always been a specialized area, **investment consultants, "retirement plan consultants," financial planners, advisors, registered reps and insurance professionals are all very different.** Compensation methodology also varies, but fees are converging. Nevertheless, in today's brave new world of full disclosure and transparency, **fees must be directly tied to the services rendered.**

As noted previously, **licensing, registration status and fiduciary "titles" are not differentiators.** Trust must be earned and while objectivity, independence and dependability are important, expert ERISA plan advisor status should be determined by the following:

- **Knowledge**
- **Experience**
- **Skills**
- **Education**
- **Credentials**
- **Scale**
- **Resources**
- **Deliverables**
- **Collateral Insulation**

Plan sponsors should demand an all encompassing relationship from their advisors. **Packaging knowledge, experience, team depth and resources in a competitive, unbiased, fully disclosed and conflict free wrapper is the path to a satisfying outcome.**

Assuming full disclosure of all fees, the avoidance of conflicts, insurance coverage and a clean background, **the object of fee analysis and benchmarking is to contrast "comparable" services and responsibilities.** Advisor skills and services obviously vary, but once a plan has determined the advisor has ability to support them, **the exact services included in their fee must be identified and evaluated.**

This guide and the EAE Program will bring independence, efficiency, documentation and clarity to that goal.

THE ADVISOR SEARCH & EVALUATION CHECKLIST

- **Determine If The Service Is Needed**
- **Identify Specific Goals & Objectives**
- **Use An Appropriate & Prudent Process**
- **Pre-Screen Candidates**
- **Communicate Up Front**
  - -Scope Of Engagement
  - -Company Background
  - -Plan Information
  - -Minimum Requirements To Bid
- **Use A Standardized Approach**
- **Ask The Right Questions**
- **Allow Adequate Time For Responses**
- **Analyze & Understand The Answers**
- **Weight Responses Based On Priorities**
- **Identify & Guard Against Political Influences**
- **Avoid Decisions Based On Sales Presentations & Personalities**
- **Re-Evaluate The Candidates & Service If The Goals Or Circumstances Change**
- **Emphasize Knowledge, Experience, Skills, Depth, Resources, Deliverables & Insulation**
- **Make An Informed & Objective Decision**
- **Document The Process**
- **Monitor The Results**

CHAPTER ONE:
Plan Sponsor Fiduciary Duties & Responsibilities

The retirement plans industry is facing increased liability, litigation, major regulatory reform, uncertain investment markets and biased mainstream media coverage. While the final outcome is unknown, **regulatory reform could have a disruptive impact on the industry**. As the regulatory reform puzzle unravels, the industry is bracing for increased complexity and new compliance demands.

Given this unsettled background, **it has never been more important for plan fiduciaries to understand their legal responsibilities and personal liability** under the Employee Retirement Security Income Act (ERISA)

Administering or managing a plan involves specific responsibilities. To meet these responsibilities, sponsors need to understand their ERISA obligations, including the standards of care. Many fail to realize it, but plan **fiduciaries are held to extremely high standards**. As noted by various courts, the fiduciary obligation to plan participants and their beneficiaries are the highest known to law.

Fiduciary status is based on the functions performed, not on a job title. Generally, **anyone with "discretion" to manage, administer or control plan assets is a fiduciary.** A plan must have at least one fiduciary (person or entity) named in the plan document. Fiduciaries normally include trustees, individuals who exercise discretion, committee members, those who select plan officials and INVESTMENT ADVISORS.

The primary fiduciary duties imposed by ERISA include loyalty, prudence, diversification and the duty to follow the plan documents. Loyalty underlies all fiduciary duties and requires fiduciaries to perform their duties **"solely in the interests of participants"** and for the **"exclusive purpose"** of providing them with retirement benefits.

Fiduciaries must also manage their plan's investments under the **"prudent man rule."** This rule requires fiduciaries to act with the care, skill and diligence of a hypothetical prudent fiduciary expert.

In addition to these high standards, fiduciaries must:

- Establish A Prudent Process For Selecting Investment Alternatives & Service Providers
- Select Investment Alternatives That Are Prudent, Suitable & Adequately Diversified
- Ensure That All Fees Paid To Service Providers & Other Expenses Are Reasonable When Compared To The Quality Of Services Provided
- Monitor Investment Alternatives & Service Providers Periodically To Ensure They Remain Prudent Choices

While ERISA fiduciaries are held to the standards of a hypothetical expert, the law does not require them to be experts. In the event they are not qualified to perform their duties, the DOL and the courts have taken the position that **fiduciaries must seek the services of an independent expert** (advisor, consultant, broker, agent, etc.) Unfortunately, there is no universal definition of “independent” or “expert.”

Sponsors seeking insulation should note that while reliance on an independent expert advisor does not fully immunize fiduciaries, it is looked upon favorably by the courts when the plan sponsor is charged with an alleged breach of duty.

In addition to the legal responsibility for the plan’s investments, the fiduciaries must prudently select and “monitor” their advisor. The prudent process of selecting an advisor is essential because as noted by the courts, **failure to utilize due care when selecting service providers, including advisors, constitutes a breach of fiduciary duty.**

The importance of the advisor selection process is further emphasized by the fact that **fiduciaries may not wholly rely on the advisor’s advice** without exercising an element of independent judgment. Although they are not required to have the same level of expertise as their advisor, **plan fiduciaries must evaluate and determine if the advisor’s advice is prudent before it is implemented.**

To maintain the potential insulation offered by an expert advisor, **fiduciaries must thoroughly evaluate the advisor’s qualifications, including the “reasonableness” of all advisor related fees.** Reasonableness and value are key concepts because the DOL does not require fiduciaries to select the low cost bid.

In addition to obtaining full disclosure of all forms of advisor compensation, conflicts and prohibited transactions must be avoided.

It is rarely discussed, but **sponsors are responsible for the activities of the vendors and advisors given access to their facilities and participants.** Because selective access is effectively an endorsement, the liability may extend to participant advice that does not involve the plan.

Given that cross-selling is a common business practice, participant advice may increase the level of risk for plan fiduciaries. As a result, **advisor practices at the participant level should be determined by the plan sponsor, vetted and monitored.** They could also be restricted through formal communications with participants and the service agreement.

CHAPTER TWO:
The Risk Of Relationship Sales

Selecting an expert advisor is the single most important fiduciary decision facing plan sponsors. As noted many times, ERISA plans are complicated and they can't be serviced by generalists who lack the knowledge and years of specialized experience required to support these plans.

The majority of smaller plans are serviced by various types of intermediaries who are generally not in a position to add value. Due to their lack of ERISA related knowledge, it is important for plan sponsors to understand that regardless of their intermediary relationship, **generalists increase fiduciary risk.**

As awareness of their fiduciary responsibility grows, sponsors have become more serious about the legal duty to retain experts rather than opting for the comfort associated with channeling business to pre-established relationships.

Plan sponsors may find the awarding of business to existing relationships painless, i.e., it precludes fear of the unknown, but **generalists can't provide insulation or relieve pain points.** Given the biased press coverage, intense scrutiny, increased litigation, regulatory reform, personal liability and the unprecedented need to manage risk, **plan fiduciaries should not be hesitant to replace generalists with expert retirement plan advisors.**

The awarding of ERISA business to less than qualified friends, relatives and quid pro quo arrangements has never been prudent. As liability and litigation increase, this prohibited activity has also become dangerous as well as indefensible.

Sponsors who operate their plans without expert assistance carry a heavy fiduciary burden and increased liability. Recognizing their liability, direct-sold plans have been adding advisors for years and the trend is expected to continue.

Of the nation's more than 600,000 DC plans, less than 20% lack an advisor. Given that most of the nation's plans are small, we would estimate that **80% of the plans with an advisor are currently serviced by non-insulating generalists.**

The mid-market is intensely competitive and while some consolidation of retirement plan advisory services has taken place in the small plan market, it has been offset by new generalist business. This new small plan generalist business is generally teamed with negative value and compensation that can't be justified.

Approximately 10% of all plans with an advisor are looking for a replacement. As regulatory reform marches ahead and sponsors become more aware of their duties & liability, **the majority of generalists will be replaced by specialists.**

Plan formations have peaked and the $3.5 trillion in DC plan assets may be static, but **expert retirement plan advisors remain a positive catalyst for improvement.**

CHAPTER THREE: Developing A Prudent & Appropriate Process

We have already noted that **fiduciaries must utilize a prudent process for all fiduciary decisions,** including the evaluation, selection and monitoring of their advisors. Fiduciaries who fail to use a prudent process may be personally liable for any plan losses, including lost earnings.

In addition to being prudent, the process must be appropriate, i.e., sponsors can't spend $25,000 evaluating a low cost service.

The basic steps to a prudent process include:

- Self Assess Internal Expertise
- Identify The Issues For Evaluation
- Determine The Relevant Information Pertinent To Decision Making
- Gather & Evaluate The Information
- Identify, Understand & Benchmark The Associated Costs
- Measure Quality & Value
- Retain The Services Of An Expert (If Expertise Is Lacking)
- Make An Informed Decision
- Implement The Decision
- Document The Process
- Retain Data/Record Minutes
- Monitor The Decision

Based on numerous DOL documents and court decisions, **costs must be compared, benchmarked and related to value.** They must also be **compared to other providers** offering similar products or services and measured against the effectiveness of the expenditure.

Recognizing value as a key issue, **a growing number of sponsors are asking advisors to prove their worth** during the RFP process. Like the words independent, affiliate and expert, *the value of expert counsel* is not easy to define. The EAE process will, however, make it easy to separate expert retirement plan advisors from generalists.

Given that fiduciary relationships are under intense scrutiny and that appropriate consideration must be given to relevant facts & circumstances, **sponsors who integrate benchmarking into their process have a better chance of defending their decisions.**

When evaluating costs, it is important to note that benchmarking total plan cost is of little value because **each component of total cost must be reasonable.**

Industry benchmarking is generally used to compare similar vendors, products and services, but it could also be applied to advisors. When evaluating the benchmarked data, sponsors would be wise to **weight the most important criteria.**

While each vendor's pricing, features and services are usually benchmarked, **the plan could also be measured against other similar plans as well as a targeted measurement of success**. The internal process would compare actual participation, deferral rates and asset allocation to the sponsor's goals. Distributions could also be benchmarked. Given that 401(k) plans are supplemental plans, care should be taken when benchmarking projected balances against retirement income needs.

Although advisor approaches to benchmarking vary widely, non-investment reporting is an area where advisors can add value. As a collector of data, advisors are well positioned to standardize data and assume a leadership role.

From a legal standpoint, **fiduciary duty is about the process**, not results. As noted by the courts on numerous occasions, **the results are far less important than the path** to an informed decision. An informed decision must, however, be based on what the fiduciary *should* know rather than what they do know and that is why the services of an unbiased expert advisor are so important.

CHAPTER FOUR:
Criteria For Retirement Plan Advisor Evaluation

The financial services industry is subject to a barrage of surveys and industry funded research with pre-determined conclusions. Unfortunately, the alleged research is often of little value. Survey creators are generally in the marketing business and they rarely, if ever, ask *the right* questions.

While the basis for any RFP evaluation must be specific to the task at hand, the key to a positive outcome lies in the ability to **determine what criteria are most meaningful.** After the criteria have been determined, the sponsor must still **ask *the right* questions**. Additionally, the sponsor must be in a position to fully **comprehend and evaluate the answers.**

Retirement plan advisory searches are not about comparing total cost, they are about determining EXPERIENCE, KNOWLEDGE, capability, resources, standards, insulation, value, fit, stability and deliverables. In short, finding a non-conflicted retirement plans expert who can meet needs, solve problems, offer value and function as a plan advocate.

If the sponsor has done their homework and **pre-screened candidates** against minimum criteria, multiple advisors participating in the search should be capable of meeting their needs. Fortunately or unfortunately, chemistry plays a role. Acknowledging human limitations, sponsors should remind themselves of their ERISA responsibilities and **conduct their due diligence on a product, service, feature, individual, team, etc., rather than the sales presentation.**

Regardless of who is responding to the RFP or making the finals presentation, sponsors should **identify and evaluate the individuals who will be assigned to their account.** When large consulting firms are participating in a search, identifying these individuals can be particularly challenging and subsequent turnover is always a risk.

As previously noted, sponsors should define their needs and goals before the evaluation process starts. Given that a successful outcome requires "specific" needs to be met, it is important to remember that **there is a vast difference between investment experts, retirement plan experts, financial planners, advisors, registered reps and insurance professionals.**

In the past, plan sponsors changed vendors frequently. Given the agony of the transition process, one can only conclude that their decisions were based on the sales process rather than on a meaningful vendor selection process.

Based on extensive network feedback, suggested criteria for the evaluation of an independent retirement plan expert advisor is listed on the next page.

CRITICA FOR RETIREMENT PLAN ADVISOR EVALUATION

- Registration Status, Licensing & Standards
- Disciplinary History (ADV I, II & U-4)
- Background Check
- Education/Certifications/Designations
- Professional Associations/Memberships
- Awards, Recognitions & Honors
- E&O Insurance/Affirmative Fiduciary Coverage
- ERISA Investment Bond
- Employee Dishonesty Insurance
- Investment Advisory /Service Agreement
- Flexibility/Requirements To Assume An ERISA Fiduciary Role
- Conflicts & Disclosure
- Entity Status
- Size, Strength, Resources & Team Depth
- Retirement Plans Experience
- Menu Of Retirement Plan Services
- Areas of Retirement Plans Expertise
- Retirement Plans Practice Profile
- Target Market
- Scale & Efficiency
- Collateral Resources
- Defined Processes, Practices, Procedures

- Retirement Plan Fees & Methodology
- Menu of Non-Retirement Plan Services
- Non Retirement Plan Fees & Methodology
- Cross-Selling & Prohibited Transactions
- Asset Custody
- Discretionary Control/Withdrawal Flexibility
- References

Gaps always exist, but the retirement plans market and the financial services industry are both over regulated and over complicated. Many of the rules and regulations are subject to interpretation. Some are also ignored. In spite of the existing maze, **major regulatory reform is on the horizon**.

The looming **reform could have a disruptive impact on the retirement plans market and the financial services industry.** It will also have an impact on the criteria for advisor evaluation. Like some plan sponsors, many in the financial services industry fail to comprehend the full parameters of ERISA standards, existing regulations and the potential impact of regulatory reform.

While ERISA requires plan fiduciaries to either be experts or hire experts, this is no easy task. Fortunately, **the EAE will allow plan sponsors to perform an independent, efficient, cost effective documented and defensible process for the evaluation of retirement plan advisors.**

To assist with this dilemma, the **subsequent chapters will provide detailed background information** on the suggested criteria. Understanding the criteria is essential for a successful evaluation outcome because each topic is generally subject to a myriad of questions during a typical RFP process.

Given the rapidly evolving environment, **this dynamic guide will be updated frequently.** The updates will keep sponsors current with changing industry conditions, regulatory reform, the appropriate criteria for advisor evaluation and ease the pain of the evaluation process.

CHAPTER FIVE:
Advisor Registration Status, Licensing & Standards

Facing ever complicated products, investment conditions, scrutiny and liability, plan sponsors have increasingly turned to financial intermediaries for help. While they may provide similar products and services in the eyes of the buyer, **the regulatory landscape governing financial intermediaries is dated and varies widely.**

Historically, most plan sponsors were not cognizant of the differences between the various categories of licensing, registration and fiduciary standards applicable to financial intermediaries. As a result of an active press, exposure to qualified specialists, the events of 2008 and regulatory reform, **sponsors are slowly becoming more aware of fiduciary standards.**

While clients generally enter into relationships with financial intermediaries based on trust, it is important to note that many financial intermediaries do not currently have a *legal* requirement to place a client's interest first. That does not, however, preclude them from doing so.

As noted in the Preface, **the fiduciary status of advisors remains unsettled.** Regardless of licensing, registration and acknowledged fiduciary status, many believe that advisors who service ERISA plans are functional fiduciaries. If that view is correct, advisors already have a legal obligation under ERISA to disclose all forms of compensation, avoid conflicts and operate with a duty of loyalty to plan participants.

While the final outcome of regulatory reform and attempts to implement a universal fiduciary standard are unknown at this time, it is important to note that ERISA fiduciary standards are the highest standards known to law. In other words, **ERISA's fiduciary standards are already higher than all existing and proposed standards applicable to the various categories of financial intermediaries.**

Fee based legislation is still a possibility, but frustrated by the lack of legislative guidance and regulatory standards for disclosure, the DOL released their long awaited "point of sale" 408(b)(2) fee disclosure regulations in July, 2010. In addition to fee disclosure, **the new regulations require service providers to note if they expect to serve as a fiduciary or a Registered Investment Advisor.**

Like the new DOL regulations, **the new financial regulatory reform legislation did not mandate a SEC type fiduciary standard for the B-D community, but it did "authorize" the SEC to develop rules to create a higher ethical standard.**

The DOL's new disclosure rules did not expand or clarify their dated definition of a fiduciary advisor, but **many expect the DOL to eventually trump the SEC's fiduciary standard.** Absent a new business model, this could pose serious challenges for non RIA financial intermediaries. **Without a new exemption, the functional fiduciary "grey zone" would no doubt become a prohibited transaction.**

The financial services industry and the retirement plans market are maturing. **Standards of conduct are also evolving and many advisor practices are in transition.** As the retirement plans component of their business grows, advisors are re-evaluating their practices to determine the type of entity that allows them to provide competitive services that are in the best interest of their clients. This step requires advisors to evaluate the pros and cons of Broker-Dealer association, dual registration, establishing their own Registered Investment Advisor (RIA) practice or joining an independent firm as an IAR.

When evaluating advisors, sponsors should take care to note that like association conduct codes, **registration categories are not credentials**. In other words, they do not reflect the knowledge, experience, training, capabilities, resources and scale required to service ERISA plans. This is an important observation because **only a small percentage of the practitioners in any profession reach a high level of competence.** Credentials, designations and fiduciary standards are good things, but they do not qualify an advisor to service ERISA plans.

To help sponsors understand the regulatory landscape applicable to financial intermediary licensing and registration, this chapter will discuss the following categories:

- Insurance Agents
- Insurance Agents/Registered Reps
- Registered Reps
- RIAs/IARs

Registered reps who are dually registered will be discussed in chapter six. Insurance agents who are registered reps could also become IARs or RIAs, but they have not been included in a separate category.

Securities Regulation & Insurance Licensing

The Securities and Exchange Commission (SEC) was established by Congress in 1934 to regulate the equity markets and administer laws that govern the securities industry. These laws include the Securities Exchange Act of 1934, which regulates Broker-Dealers (B-Ds) and the Investment Advisers Act of 1940, which regulates Registered Investment Advisers (RIAs).

In addition to the SEC, the National Association of Securities Dealers (NASD) was founded as a self-regulatory organization in 1939 and was succeeded by the Financial Industry Regulatory Authority (FINRA) in 2007. FINRA is responsible for the regulation of B-Ds, registered representatives (registered reps), enforcement and arbitration. Although larger RIAs are still regulated by the SEC, smaller RIAs are state regulated.

Insurance agents and brokers are state regulated and must obtain licenses in the states where they plan to conduct business. Separate licenses are required for Life & Health as well as Property & Casualty Insurance. The insurance industry is moving toward uniform state licensing standards. As the demand for financial planning increases, **a growing number of insurance intermediaries are pursuing their securities licenses and becoming registered reps.**

Insurance Agents & Brokers: Limited Suitability & Standards

While over 1.3 million individuals hold insurance licenses of all types, the number of actively licensed insurance agents and brokers is around 1.0 million.

Insurance intermediaries working for one insurance company are referred to as captive agents while independents or brokers may represent numerous companies. To preclude "selling away," captives may have access to pre-approved outside products, but their compensation and benefit credits may be skewed towards proprietary products.

Approximately 300,000 of the 1.0 million active insurance producers are also FINRA registered, but **Life & Health licensed producers may not have to be securities registered to sell group annuity products to retirement plans.**

Insurance brokers and agents are typically licensed under state insurance laws, but as noted, they could also be registered reps under the Securities Exchange Act of 1934. Very few are registered as RIAs. Unlike registered reps and RIAs, **state insurance laws make little reference to suitability or fiduciary standards.** Like registered reps and RIAs, insurance brokers and agents could, however, become functional fiduciaries under ERISA.

Registered Representatives: Suitability

Approximately 5,000 B-D firms are registered with FINRA, including wirehouses, independents, regionals and others. Over 600,000 registered representatives operate under B-D umbrellas, including 300,000 - 400,000 active producers and 150,000 advisors with dual registration.

Mergers/acquisitions have unsettled the large wirehouse B-D landscape. Stripping the hype away, DC plan flexibility, including the ability to assume an ERISA fiduciary role & operate with dual registration, varies widely among B-Ds. The additional flexibility is also generally limited to a very small group that meets internal standards. These restrictions, along with financial instability, an emphasis on proprietary products & new technology, have fueled the growth behind independent B-Ds and RIAs.

Registered reps, also known as financial advisors, financial consultants and brokers, are sometimes viewed as salespeople by RIA purists. They are typically Series 6 or 7 licensed, affiliated with a B-D and earn commissions on transaction-based business. Registered reps may also provide investment advice if it is "incidental" to their business under a suitability standard.

B-Ds are regulated under the Securities Exchange Act of 1934 and as such, are not deemed to be fiduciaries under Securities law. **The B-Ds' registered reps are subject to the "suitability" standard and are not required to place client interests ahead of their own.** While they are not required to function in a fiduciary capacity, and in many cases are not permitted, it is important to note that **many registered reps operate with a fiduciary standard of care.** However, this fact may not be acknowledged to the client.

The 1934 Act is often referred to as a **rules-based** statute. By following the suitability rule and providing disclosure, B-Ds have generally been protected from liability even when engaging in practices that might not be in the best interest of clients.

B-Ds were initially transaction-based organizations, but the landscape has changed in recent years. Today, many registered representatives provide investment advice, deemed as incidental, similar to the services offered by RIAs.

RIAs: Fiduciary Standard

Meaningful industry data on the different categories of registration is difficult to decipher, particularly at the RIA level. The RIA title includes large money managers as well as one-man advisory firms.

Excluding hedge funds, approximately 10,000 RIAs are registered with the SEC. The RIAs registered with the SEC are tracked at the firm level and do not reflect the number of individual Investment Advisor Representatives (IARs) employed at or operating under the RIA. Most RIAs are, however, small firms and employ five or fewer employees.

Given that many SEC registered firms are also state registered, it is difficult to obtain meaningful information on the incremental number of small state registered RIAs and the IARs operating under their umbrella. Nevertheless, **the number of state registered RIAs is no doubt comparable to the number of RIAs registered with the SEC.**

RIAs may or may not have a B-D affiliation, but unlike registered reps, RIA compensation is not transaction-based. RIAs are compensated on a fee basis, including hourly fees, flat dollar fees, asset-based fees, graded asset fees and other arrangements. The fees charged by the RIA could be project based or recurring.

Prior to the regulatory reform legislation initiated in mid 2010, RIAs with more than $30 million in assets under advisement were required to register with the SEC by completing Form ADV Parts I & II. The ADV is a two-part disclosure and anti-fraud document. The first part answers basic questions, including ownership disclosure and disciplinary events. The second part consists of narrative disclosure, including potential conflicts.

Subsequent to the passage of regulatory reform, the oversight of RIAs with assets under advisement in the $25-100 million range was transferred to the state level. The only way for RIAs will less than $100 million under advisement to remain under SEC jurisdiction is to be registered in at least 15 states.

Part II of the Form ADV was also revised to better outline the advisor's qualifications, investment strategy and business practices. **The amendments were designed to serve investors' needs by describing the advisor's conflicts, compensation, business activities and disciplinary history** in more detail. The new brochures are expected to be distributed during the first quarter of 2011.

While the word fiduciary is not prominent in the Investment Advisers Act of 1940, the courts have recognized the fiduciary nature of the investment advisory relationship as well as the Congressional intent to eliminate and/or manage conflicts of interest. As a result, pure **RIAs must follow the fiduciary standard of the principles-based statute and place client interests ahead of their own under Securities law.**

The nature of a fiduciary relationship is complex and generally receives little attention in compliance material. While practical guidance may be lacking, **the broad fiduciary principles imposed by law include a duty of due care, loyalty and utmost good faith, i.e., the avoidance of conflicts and self-dealing.**

Due care is relational and consists of both a substantive (judgment) and a procedural (prudent process) duty. While the duty of utmost good faith is often viewed as separate from other duties, it is the duty of loyalty that is the most demanding. It requires **full disclosure of all material facts as well as conflicts of interest, which include all forms of compensation.**

While RIAs must adhere to a fiduciary standard by Securities law, that does not mean they are more knowledgeable or more specialized than other financial intermediaries. RIAs may or may not be credentialed, most do not have the CFP, ChFC or CFA designations, and the scope of the registered rep required Series 6 or 7 is far broader than the Series 65.

ERISA: The High Ground

The Employee Retirement Income Security Act of 1974 (ERISA) is a federal statute that establishes minimum standards for pension plans in private industry and provides extensive rules on the federal income tax effects of transactions associated with employee benefit plans. **ERISA was enacted to protect the interest of plan participants and their beneficiaries by requiring disclosure, establishing standards of conduct, providing appropriate remedies and access to federal courts.**

ERISA enforcement is divided among the Department of Labor, the Department of the Treasury, the Internal Revenue Service and the Pension Benefit Guaranty Corporation.

In contrast to the Investment Advisers Act of 1940, which requires RIAs to act in the best interest of clients, **ERISA requires fiduciaries to act "solely" in the interest of plan participants and their beneficiaries.** ERISA fiduciaries must also act in accordance with the terms of the plan's document and ensure the reasonableness of fees. Additionally, ERISA requires fiduciaries to act with the care, skill, prudence and due diligence of a knowledgeable person acting in a like capacity and familiar with such matters.

The "sole interest" and "exclusive purpose" rules under ERISA are drawn from trust law. The duties of loyalty and prudence also underlie fiduciary trust law.

CHAPTER SIX
Dual Registration:

The pure investment advisor industry has changed little in recent decades. However, with the introduction of fee-based brokerage accounts in the 90s, transaction rooted B-Ds began marketing programs that provide ongoing investment advice for asset-based compensation.

B-Ds often refer to their registered representatives as financial advisors. While they may offer services that are indistinguishable from RIAs, some feel they have been providing investment advice outside the regulatory framework governing investment advisors.

Because intermediary regulation has been based on the type of firm an advisor works for rather than the services provided, some purists claim that B-D clients lack the regulatory protection offered by a formal investment advisory relationship. On the other hand, the FINRA oversight of B-Ds is more considerable than the SEC regulatory oversight of RIAs.

The licensing (Series 6 & 7) and CE requirements are also far more stringent for registered reps than RIAs. To our knowledge, pure RIAs have no CE requirements and some states don't even require the Series 65 examination.

Dual registration is complicated and it has added to the confusion surrounding the differences between B-Ds (registered reps) and RIAs. Indeed, **the dual registration flexibility allows a registered rep to switch from wearing a non-fiduciary hat to a fiduciary hat while servicing the same client.**

By broadening the broker-dealer exclusion and ignoring the legal principal that fiduciary duties apply to the entirety of a client relationship, some feel the SEC has limited the application of the Investment Advisers Act of 1940 and circumvented Congressional intent.

Why Dual Registration

The market for financial advice has evolved. Wealthy individuals do not respond to the typical sales approach and many are looking to simplify their life through account consolidation. **The plan sponsor decision making process has also evolved and the savvy are looking for fiduciary partners.**

On the other hand, advisors are seeking investment & pricing flexibility, technology and operational support. When the advisor operates as an IAR under a B-D's RIA, the regulatory and administrative burden, along with liability, could also be transferred to the B-D.

In addition to the much needed technical support and guidance, dual registration allows advisors to reduce costs and increase profits. Dually registered advisors also benefit from more time to spend on client support and asset gathering.

B-Ds clearly want to retain successful advisors who have developed fee-based business. They also want their slice of ERISA business. Regulatory reform could change things, but the ability to acknowledge **fiduciary status under ERISA is currently limited to banks, insurance companies and RIAs.** To remain competitive, B-Ds enter into contracts under their RIA arm.

This is an important point because the retirement plan engagement morphs a registered representative from rules-based suitability, to principles-based RIA conflict disclosure and finally to an ERISA standard which requires conflict avoidance. The avoidance of conflict is why some B-Ds preclude many dually registered IARs from acknowledging an ERISA fiduciary role, particularly those who hold assets long. Refusing to acknowledge a fiduciary role may also help B-Ds resolve disputes based on the suitability standard.

As the competitive marketplace evolves and the costs of operating a small RIA shop increase, **registered reps are increasingly gravitating towards dual registration.** Given that this trend is expected to continue, it is important for plan sponsors to understand the nuances of dual registration.

In short, the advantages of the hybrid status allow advisors to:

- Maintain/Increase Market Share
- Differentiate Themselves
- Provide Investment Advice Beyond That Which Is Incidental
- Capture High Net Worth Fee-Based Business
- Service Smaller Accounts On A Commission Basis
- Facilitate Business With More Sophisticated Plan Sponsors

Dual Registration Is Not Homogeneous

Common law aside, consultants who refuse to acknowledge fiduciary responsibility may be free to pursue self-interests. Contrastingly, an acknowledged ERISA fiduciary role comes with serious responsibility and constraints.

When vetting advisors, including those dually registered, sponsors should note that investment advisory agreements are all over the map. **Some investment advisory agreements are competitive, others purposefully omit acknowledgement of fiduciary status while still others use carefully crafted language to limit their responsibilities and liability.**

Regardless of the establishment of a consulting relationship, contracts lacking meaningful language may not mitigate a sponsor's liability. Given that determining functional fiduciary status is no easy task, sponsors - and their attorneys - are increasingly analyzing the details of the investment advisory contract. The contract analysis generally centers on **a review of the advisor's fiduciary obligations as well as insurance coverage and bonding requirements.**

Dually registered advisors who are associated with a wirehouse or major B-D are generally required to use the B-D's RIA contract. Large independent RIAs with a B-D affiliation may or may not be required to use the B-D's RIA contract. Pure RIAs use their own contract. Some B-Ds look the other way, but regardless of the contract source, B-Ds generally supervise the RIA's activities and many require an independent audit.

While independent B-Ds generally don't limit advisors who wish to be dually registered, some wirehouses severely limit the number of registered reps allowed to operate as IARs. RIA contracts also vary widely and some wirehouses use more flexible contracts for larger plans. **Indemnification and arbitration language may be similar in many of the hybrid firm contracts, but the fiduciary language, acceptance and threshold varies significantly.**

B-D insurance coverage varies widely and may not cover ERISA related IAR activity under the master policy. While independents may be able to purchase a stand-alone E&O insurance policy, intermediaries categorized as employees may not be able to purchase the coverage. Policy aggregation of individual claims may also limit coverage and preclude advisors from participating in a RFP process.

A number of RIA contracts are clearly conflicted for a variety of different reasons. Some B-Ds custody retirement plan assets while others avoid the potential conflict. **Dually registered individuals under the same B-D may also operate quite differently.**

The flexibility to give sponsors what they want is important from a business standpoint. Nevertheless, some dually registered advisors collect non-directed 12b-1 commissions/fees while others operate without conflict. Those who don't direct their commissions to an ERISA account often note that they operate with a fiduciary standard that is required by their designations, but that holds little water when compared to a legal contract.

To avoid conflict on their commission business, other advisors charge the same set fee, but the commissions/fees are redirected and the level compensation is paid from an ERISA budget Account. **Level compensation that is excessive does not, however, preclude conflicts.**

The Bottom Line On Dual Registration

As noted many times, ERISA requires conflict avoidance. ERISA conflicts generally revolve around the rules governing breach of fiduciary duty and prohibited transaction rules, including self-dealing.

Dual registration offers advisors many business related advantages and is no longer viewed as a transitory step. While dual registration status may not place advisors at a competitive disadvantage below the large plan market, pure RIAs could make an issue of potential conflicts.

Showcasing neutrality is important because a dually registered advisor who uses an independent RIA contract with insulating language, avoids all conflicts, is not in a position to effect compensation - including affiliate compensation - and whose B-D does not serve as BOR or hold the assets, could still be challenged by a pure RIA looking for an edge.

Nevertheless, **there is little reason why a highly skilled, dually registered retirement plan advisor with a competitive investment advisory contract and a conflict free approach should be viewed as less competitive than a pure RIA**, particularly those light on retirement plans experience, depth, resources & insulation.

For more information on designations & securities licenses, see the CFP document on "Policies, Renewal Requirements & CE Standards" located at: http://www.cfp.net/Downloads/RenewalCE1_06.pdf.

Additional information on securities licenses & designations can be found by visiting Investopedia at: http://www.investopedia.com/articles/financialcareers/07/securities_licenses.asp.

DOL Fiduciary Campaign

The DOL's Fiduciary Education Campaign website page contains a number of documents to help plan sponsors fulfill their fiduciary duties under ERISA. While far too limited, the document on "Selecting & Monitoring Pension Consultants – Tips For Plan Fiduciaries," suggests the following questions:

- ***Are you registered with the SEC or a state securities regulator as an investment adviser? If so, have you provided all the disclosures required under those laws, including Part II of the Form ADV?***

- ***If you are hired, will you acknowledge in writing that you have a fiduciary obligation as an investment adviser to the plan while providing the consulting services we are seeking?***

- ***Do you consider yourself a fiduciary under ERISA with respect to the recommendations you provide the plan?***

For more information on the DOL's Fiduciary Education Campaign, please visit their website located at: http://www.dol.gov/ebsa/fiduciaryeducation.html. For more information on how to evaluate pension consultants, please visit the CFDD's website page on Evaluating Pension Consultants & Advisors located at: http://www.thecfdd.com/evaluatingpensionconsultants.

CHAPTER SEVEN
Regulatory Reform & Retirement Plans Advisors

Chapter Seven will discuss select areas of regulatory reform that will have a major impact on the financial services and retirement plans advisory industry. Some of the new rules are still pending, but our summary will focus on:

- Plan Level Fee Disclosure Regulations
- Regulatory Reform Legislation
- Participant Level Fee Disclosure Regulations
- Investment Advice Regulations
- New Form 5500 Schedule C
- Revised Form ADV, Part II
- 12b-1 Fee Proposal
- Advisor Disclosure & Public Database Reporting

Regulatory Reform In A Nutshell

Many in the financial services industry continue to beat the fiduciary drum with religious type zeal. Unfortunately the necessary qualifications to function as an ERISA fiduciary are rarely discussed. Acknowledging a fiduciary role is becoming essential to the sales process, but as noted many times throughout this guide, **titles and a willingness to assume an ERISA fiduciary role do not automatically qualify one to function in that capacity.**

Fee based legislation is still a possibility, but frustrated by the lack of legislative guidance and regulatory standards for disclosure, the DOL released their long awaited "point of sale" 408b-2 fee disclosure regulations in July, 2010. The new rules were designed to **help plan sponsors assess the reasonableness of their contracts, service provider compensation, conflicts and fiduciary status.**

In addition to fee disclosure and a list of services provided, the new regulations require providers to indicate if they expect to provide services as a fiduciary or a Registered Investment Advisor. The DOL's new disclosure rules did not expand or clarify their dated definition of a fiduciary, but **the new rules make it harder for advisors to deny they are operating as functional fiduciaries.**

In light of the new disclosure rules, proposed 12b-1 fee changes, Form 5500 disclosure and evolving standards, the days of servicing retirement plans as a non-fiduciary advisor are coming to a close. Given that **a higher standard seems imminent**, non-RIA type financial intermediaries are facing major challenges.

The DOL's new "point of sale" fee disclosure regulations are in addition to the "after the fact" reporting of direct and indirect compensation on the Schedule C. New participant level disclosure will eventually complete the triad of fee disclosure. The final rules on participant level fee disclosure have been submitted to the OMB and should be published before the end of 2010.

The final wording of the DOL's Investment Advice rules is expected to be released before the end of 2010. The DOL has also increased scrutiny of the fees received by TPAs. While not related to fee disclosure or fiduciary status, recent court rulings on excessive fee cases are expected to encourage additional litigation against plan sponsors.

Like the new DOL regulations, **the new financial regulatory reform legislation did not mandate a SEC type fiduciary standard for the BD community, but it did "authorize" the SEC to develop rules to create a higher ethical standard.**

The regulatory reform legislation **transferred the oversight of approximately 4,000 RIAs with $25-100 million under advisement to the states** and authorized the SEC to study whether self-reporting organizations, like FINRA, should oversee registered investment advisors. As a result of the transfer, increased audits of RIA firms by the SEC and state securities departments are expected.

To enhance disclosure, the SEC adopted changes to Part II of Form ADV and proposed major changes to the 12b-1 fee structure. If enacted, the 12b-1 proposal could have a significant impact on the financial services industry.

FINRA & State regulators have taken steps to harmonize, expand and report disciplinary disclosure of advisors and registered reps, including unsupported allegations. Certain information, like criminal convictions, civil actions and arbitration awards, will remain archived on a permanent basis.

DOL Regulations, Fee Disclosure & Fiduciary Status

The DOL published their long-awaited 408b-2 regulations on 7/15/10. To avoid prohibited transactions, retirement plan providers must be compliant by 7/16/11.

Section 408(b)(2) of ERISA exempts service providers from engaging prohibited transactions. Relief is provided for contracts/arrangements between parties in interest **if the contact/arrangements are reasonable, necessary for the establishment & operation of the plan and no more than reasonable compensation is paid.**

The rule has been in existence for decades, but it was amended to provide a uniform regulatory disclosure standard. Moving beyond the 2007 proposal, the final regulation focuses on written disclosure rather than revising existing contracts. It also eliminates the 2007 proposal requirement to provide a narrative description of conflicts.

As indicated, the new interim rule provides **a more detailed list of requirements that must be disclosed before a contract or arrangement can be considered reasonable**. Going beyond disclosure, the sponsor must also determine if the arrangement is reasonable.

Covered service providers fall into three categories and include: those who expect to serve as an ERISA fiduciary or as a Registered Investment Advisor, recordkeeping & brokerage services and those who expect to receive “indirect” compensation.

Indirect compensation includes accounting, auditing, actuarial, appraisal, banking, consulting, the selection/monitoring of service providers & plan investments, legal, recordkeeping, securities, third party administration and valuation services.

The covered service providers must disclose the information below in advance of the contract or service initiation:

- A description of the services to be provided.
- If applicable, a statement noting that services will be provided as an ERISA fiduciary or a registered investment advisor.
- A description of all direct and indirect compensation paid. The description must identify the services for which the compensation is paid, the payers and recipients.
- Compensation for termination.

While the new regulation does not require a service contract or mandate a lengthy description of services, advisors would be wise to provide a comprehensive listing of services and use 408b-2 as a marketing tool. For each service listed, advisors should also clarify their fiduciary role and note the limitations of their responsibility.

Noncompliance with the disclosure and delivery requirements would result in a prohibited transaction subject to disgorgement, excise taxes, personal liability and more. While the disclosure must be in place by 7/16/11, the regulation provides plan fiduciaries with a safe harbor if they report the service provider who failed to meet the disclosure requirements to the DOL.

The new regulation is important for plan sponsors and non-fiduciary advisors. **If the advisor states they are not a fiduciary, but their written disclosure indicates they are providing investment advice, they are at risk of participating in a prohibited transaction. On the other hand, the sponsor could conclude they are not receiving advice and this could lead to a reevaluation of the advisor’s services. It could also lead to replacement by an advisor willing to accept the liability**

Qualified advisors add real value and they should be compensated for their work. Nevertheless, by highlighting the amount paid, who is paying them, the services provided and the advisor’s fiduciary status, some sponsors may be surprised by the dynamics of their advisor’s compensation. **In addition to identifying the compensation and services, plan fiduciaries should evaluate the advisor’s qualifications to provide the services.**

For the most part, advisors and plan fiduciaries have not yet felt the sting of enforcement or the prohibited transaction whip. However, the increased funding for enforcement should not be taken lightly. This chapter does not focus on cross selling and rollover practices, but regardless of the perceived value, **plan fiduciaries should be wary of cross selling practices that are in violation of ERISA's prohibited transaction rules.**

Like plan sponsors, **advisors who function as plan or participant level advisors should review the rollover procedures and disclosure documents applicable to their plan level clients to ensure ERISA compliance and reduce risk.**

For more information on this complicated and uncertain area, see Chapter Twenty Nine, *Cross-Selling, Rollover Counseling & DOL Compliance.*

For more information on the new fee disclosure regulation, see the fact sheet at:
http://www.dol.gov/ebsa/newsroom/fsimprovedfeedisclosure.html.

For more detailed information, go to the Federal Register document located at:
http://www.dol.gov/federalregister/PdfDisplay.aspx?DocId=24028

New Form 5500 Schedule C

Proposed in 2007, the new Schedule C revisions apply to the 2009 fiscal year which is due in 2010. The annual report must be filed with the IRS and is part of a three-prong initiative to improve 401(k) plan fee disclosure.

While the form includes direct and indirect compensation, **it was designed to highlight indirect payments such as 12b-1 fees, sub-TA fees, service fees, finders' fees and more**. Indirect payments were not generally reported in the past.

The new Schedule C is complicated and as a result, completion will be costly and time consuming to prepare. The compensation paid to service providers is particularly complex and the disclosures will have to be reviewed closely by the plan administrator who must sign the Form 5500 under penalty of perjury.

Because the new Form 5500 only applies to plans with more than 100 participants, **80% of the nation's plans will not benefit from the enhanced disclosure.**

Service providers who receive "eligible indirect compensation" and provide certain disclosure items to the plan's administrators are eligible for reduced reporting. While alternative reporting reflects the diversity of arrangements, **the practical effect will result in a wide range of reported compensation.** Providers could also customize bundled arrangements to provide a broad range of services. The chosen structure could increase or decrease the reported compensation.

The codes identifying service providers increased from 23 to 55, but the instructions do not define the new terms. Given that many services could be described by multiple codes, **the reliability of the Schedule C to provide meaningful information is questionable.**

The new Schedule C is designed to assist the DOL with its enforcement activities. For example, the Schedule C instructs the plan administrator to report service providers who fail to provide the required information. The obligation to report service providers to the DOL that fail to comply is an indirect means to force service provider reporting that is not in the statutory requirements.

In terms of disclosing total costs, compensation and conflicts, the new Schedule C is far from perfect and no doubt still a work in progress, but it may improve transparency. In addition to new enforcement tools, **the public availability of the information may encourage sponsors to review their costs/arrangements annually and provide expert retirement plan advisors with a tool to identify vulnerable plans.**

The DOL's lengthy FAQs regarding the new Form 5500 and the Schedule C can be found at: http://www.dol.gov/ebsa/faqs/faq_scheduleC.html. The DOL's Form 5500 Troubleshooter's Guide is located at: http://www.dol.gov/ebsa/pdf/troubleshootersguide.pdf.

For definitions of the codes see the Technical Release prepared by PlanTools, LLC at:
http://www.fraplantools.com/uploads/Final%20Report%20on%20Schedule%20C%20Codes%203-3-10.pdf.

Investment Advice Regulations

Copy to follow.

For more detailed information on the DOL's pending Investment Advice regulations, go to:
http://www.dol.gov/ebsa/regs/cmt-1210-AB35.html

Regulatory Reform Legislation

In addition to more disclosure and transparency, we are entering an era of governmental activism and dogmatic interpretation of the various rules governing the financial services industry, including the retirement plans industry.

The new regulatory reform legislation transferred the oversight of approximately 4,000 RIAs with $25-100 million under advisement to the states. The aforementioned advisors are currently regulated by the SEC. Going forward, the only way they could remain under SEC jurisdiction is to be registered in at least 15 different states.

In light of budget constraints, some have questioned the ability of the states to manage their new tasks. On the other hand, the states have responded by noting that less than 10% of investment advisors have been examined by the SEC in recent years.

While it has received much less attention, the reform legislation **authorized the SEC to study whether a self-regulatory organization, like FINRA, should regulate investment advisors.** In the eyes of astute observers, this opens the door for FINRA to become the regulator of the investment advisory industry.

The Elimination Of 12b-1 Fees

Coinciding with the signing of the regulatory reform legislation and consistent with a transformational industry, the SEC proposed eliminating 12b-1 fees as they currently exist.

We aren't sure about service fees or sub-TA fees, but if adopted, the proposal would limit asset-based sales charges to 0.25%. The proposal would also enhance disclosure of "ongoing" sales charges, encourage retail price competition and revise fund director oversight.

The SEC is concerned that many investors are unaware of their 12b-1 fees, who they are being paid to and why they are being paid. The SEC is no doubt seeking more equitable methodology for the sales and marketing of mutual funds, but they really don't understand how the retirement plans industry works.

While they may attract little scrutiny, 12b-1 fees are deeply embedded within the industry. If enacted, **the SEC's proposal could have major consequences for the mutual fund industry, the retirement plans industry and small investors.** Smart disclosure is a good thing, but in addition to significantly increasing costs for providers, plan sponsors and participants, the proposal could limit small plan formations and decrease participation.

Beyond retirement plans, the new proposal would increase costs to retail investors, encourage wrap accounts and further increase the trend towards fee-based business. Fueled by regulatory support for passive investments, the proposal could also have an impact on mutual fund consolidation.

In short, revenue sharing and 12b-1 fees are used to offset plan level recordkeeping/administrative costs and compensate advisors. **By limiting the ability to manage and package plan expenses, the SEC proposal could have serious unintended consequences for the retirement plans industry and small retirement plans.**

For more information on the proposal, go to: http://www.sec.gov/news/press/2010/2010-126.htm.

For more detailed information, go to: http://www.sec.gov/rules/proposed/2010/33-9128.pdf.

Revised Part II Form ADV

A decade after first proposing revisions, the SEC is adopting changes to Part II of the Form ADV, the primary disclosure document provided to clients and prospects.

The amendments require all SEC registered advisors to prepare plain English narrative supplements. While the new format and expanded information will require more effort on the part of advisors, it is expected to be more investor friendly than the check-the-box format used previously.

Known as the "brochure," Part II includes information about the advisor's business, conflicts, fees & compensation, disciplinary information, background information on the advisor & their personnel and more.

To ensure access, the form must be filed electronically through the IARD system in a searchable PDF format, a process already required for state registered RIAs.

Under the new requirements, **the brochure must be delivered to prospects before or at the time of** memorializing any contract or agreement. The brochure must also be delivered annually within 120 days of the firm's fiscal year end.

For more information on the Form ADV, go to: http://www.sec.gov/news/press/2010/2010-127.htm.

For more detailed information, go to: http://www.sec.gov/rules/proposed/2008/ia-2711.pdf.

Expanded Disclosure & Reporting

To harmonize the disciplinary disclosure of advisors and registered reps, **state regulators launched an online disclosure system similar to FINRA's BrokerCheck system** in June, 2010. The system covers all individual advisors, including those whose firms are registered with the SEC and/or the states.

The new disclosure system may be confusing to the public because **it exposes ALL disclosure items that have been filed**, including those that have NOT been adjudicated, dating back to 2002. It also includes "unproven" termination related information filed by former employers.

Like registered reps, advisors are required to self report the same customer complaints, regulatory action and job termination data as registered reps. Both groups must file the U-4 disclosure form and the U-5 termination report.

Many fail to realize it, but the states work from the same Form ADV and registration databases used by the SEC. Prior to the launch of the Investment Advisor Public Disclosure (IAPD) database, investors seeking the records of individual advisors had to contact the states. **The IAPD closed a loophole enjoyed by the registered investment advisor community.** To access the IAPD, go to: http://www.adviserinfo.sec.gov./%28S%28upqndxbgpxulkl55gecehhiy%29%29/IAPD/Content/IapdMain/iapd_SiteMap.aspx.

Consistent with the IAPD, the SEC approved a new FINRA rule that increases the amount of disciplinary information disclosed through BrokerCheck. **The new rule is designed to equalize disclosure between advisors and registered reps.**

Customer allegations, regulatory actions and arbitration awards against registered reps have long been available to the public via BrokerCheck, but only for a limited time. Rather than limiting customer allegations to two years, **"unproven" allegations dating back to 1999 will soon be available.** Additionally, **some information about "former" registered reps will be made available on a permanent basis,** including criminal convictions, certain civil actions and arbitration awards.

Additionally, the pending financial reform bill calls on the SEC to study the disciplinary disclosure system applicable to both advisors and register reps. The goal is to identify additional information that could be made available to the public.

CHAPTER EIGHT
Background Checks & Disciplinary History

Given the negative headlines, challenging markets and repeated investment scandals, **the need to establish trust through full disclosure and transparency has never been more important.**

The SEC has already increased their focus on wealth managers who hold assets through banks, brokers, advisors and accounting firms. Additionally, they have stepped up efforts to verify that account statements sourced from advisors match custodial records. Large custodians of RIA assets are also focusing on the verification of wire transfer authorizations.

Unfortunately, the fraud detection components of the nation's financial regulatory system are not fully coordinated. As a result, **the public lacks an all inclusive central depository for background checks.**

Many firms perform background checks during the hiring process and then default to self-reporting for updates. Reportable items are supposed to include formal investigations, regulatory actions, customer disputes, criminal charges and/or convictions. Financial disclosure, including bankruptcies, unpaid judgments and liens should also be disclosed.

In addition to system shortcomings, many advisors fail to self-report for a variety of reasons. While they are a good place to start, **the various regulatory databases may not be current or accurate.** Moreover, unless they are securities licensed, insurance agents may not be subject to any disclosure beyond the hiring process.

Given the importance of a background check, **sponsors should use all credible means at their disposal to check an advisor's background,** including credentialing organizations, FINRA, the SEC, NASAA, NAIC, state securities and insurance departments, the Better Business Bureau, vendors who offer background checks and the internet.

The level of risk should play a role in determining the depth of the advisor's background check. Risk assessment is important because the risk varies with the advisor's role, i.e., advising the fiduciary, custodial, independent recommendations & monitoring, discretionary investment manager, named fiduciary, etc.

Advisor Background Check/ ERISA 411 Solution

ERISA Section 411 specifically precludes those convicted of a variety of crimes, including substance abuse and other financial shortcomings, from serving ERISA plans. Even though ERISA 411 requires it, **very few plan sponsors perform background checks on their advisors.** To meet this need, the EAE Program offers an "optional" advisor background check.

As noted, **the level of risk associated with the advisor's role should determine the depth of the background check.** The advisor background check offered by the EAE Program does not include fingerprinting, but the FBI quality report does include professional licensing, regulatory issues, criminal/civil background, financial liens, judgments, bankruptcies and credit checks.

While full disclosure and transparency have never been more important, advisors must give their permission before a background check is initiated. The advisor should also see the report in advance and be given the opportunity to correct any inaccuracies. The service is not designed to undermine advisors, but rather document the required prudent process for advisor selection.

Consistent with the higher standards of ERISA and a maturing industry, **the independent, efficient and cost effective EAE is the only service that imposes minimum standards and provides meaningful due diligence on advisors, insurance policy/bonding reviews and advisor background checks**.

For more information on ERISA Section 411, visit the BenefitsLink.com website at:
http://benefitslink.com/erisa/crossreference_short.html.

Credentialing Organizations

Credentialing organizations like the CFP Board, the IMCA and others maintain high standards when advisor candidates apply. The due diligence includes background checks and cross checking with state authorities, FINRA's Central Registration Depository (CRD) and the SEC's Investment Advisor Registration Depository (IARD).

Developed by FINRA and NASAA, the **CRD** consolidated a multiple paper-based state licensing and regulatory process into a single nationwide computer system. The database contains the licensing and disciplinary histories of more than 650,000 securities professionals and 5,200 firms.

While developed jointly by NASAA and the SEC, the **IARD** is operated by FINRA. FINRA does not currently have regulatory authority over investment advisors, but the IARD is to investment advisors what the CRD is to broker-dealers. The IARD contains the employment and disciplinary histories of more than 11,000 investment firms and 173,000 individual investment advisors.

Once advisors receive their designations, they are **subject to self-reporting**, including civil matters, litigation and criminal reporting. The credentialing organizations also expect to hear from third parties, including disgruntled clients, their attorneys and other designation holders.

Cognizant of the potential risk for slander and defamation lawsuits, the organizations tend to err on the side of caution. When a series of complaints have been filed against an advisor, the organization must conduct their own internal investigation before taking any action.

Credentialing organizations often note that the disciplinary process must be fair to all parties, but **the membership of the major organizations may have become too large for these groups to routinely check the nation's regulatory databases.**

Monitoring membership conduct is further complicated by the fact that **settlements could be reached and/or sanctions imposed before the acts are reported on the organization's website.**

Credentialing organizations do not view themselves as policemen, but many feel that **more time and resources should be devoted to monitoring members** after they receive their designations.

FINRA (Registered Reps)

Registered reps (brokerage firm employees) are regulated by the Financial Industry Regulatory Authority (FINRA), the industry's self-policing body. As noted, FINRA tracks the employment, qualifications and disciplinary history of more than 650,000 advisors.

To help the "public" evaluate advisors, FINRA offers a free and widely used service called BrokerCheck. According to FINRA, twelve million advisor reviews were conducted through BrokerCheck in the year 2008 alone.

After entering an advisor's name, the online tool allows users to access complaints, outcomes, states licensed to transact business in, industry exams passed, previous employment history and outside affiliations (including compensation received from other sources.)

In the past, the public's access to disciplinary history was limited to two years after the advisor left the industry. However, **a new rule has been approved and it will significantly expand the reporting history and information available to the public through BrokerCheck.**

The additional information is expected to be available in mid-2010 and it will provide access to records dating back to 1999 along with final regulatory action from:

- FINRA
- SEC
- CFTC
- Federal Banking Agency
- National Credit Union Administration
- Other Federal Regulatory Agencies
- State Regulatory Agencies
- Foreign Regulatory Authorities

FINRA Limitations

Most registered reps have unblemished records. Less than 3% of all registered reps have multiple complaints on their records and a smaller group has more.

Nevertheless, **the histories of the 15,000 advisors who have left the industry due to regulatory action have not been available through BrokerCheck.** An additional 300-400 advisors per year are also suspended and/or barred from the industry.

Prior to the expected database upgrades, **only brokers with three or more actions against them were flagged** by BrokerCheck. **Settled complaints may also be expunged and if the complaint was filed against the firm rather than the advisor, it may not show up** on BrokerCheck.

Additionally, the U4 and U5 Forms may be subject to a lack of full disclosure at the firm level. The U4 (Uniform Application for Securities Industry Registration or Transfer) lists the advisor's qualifications and disciplinary history. The U5 (Uniform Termination Notice for Securities Industry Registration) discloses why the broker left the firm.

Leery of lawsuits and defamation, **the quality of reporting on the U5 varies greatly**. Indeed, some feel it is better to terminate the advisor and let others deal with the problematic behavior. On the other hand, advisors could be dismissed for political reasons and not have the leverage to correct their U5.

FINRA has indicated that heightened supervision is warranted for brokers whose records reflect disciplinary actions involving sales practice abuse, a history of customer complaints and/or arbitrations that were not resolved in their favor. Unfortunately, **heightened supervision may be a double-edged sword at the firm level**. In other words, the firm could be criticized for forgoing heightened supervision of a broker who meets the aforementioned criteria as well as problems emanating from brokers who were under heightened supervision.

For more information on the professional background of current and former FINRA-registered brokerage firms & advisors, FINRA's Broker Check may be visited at:
http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/index.htm.

For other FINRA enforcement actions, including Sanction Guidelines, Adjudication and Disciplinary Actions, visit: http://www.finra.org/Industry/Enforcement/index.htm.

SEC & State Securities Regulators

Depending on the amount of assets under advisement, investment advisors (RIAs) are regulated by the SEC or state regulators. The SEC registers RIA firms, but does not register individual representatives (IARs) of RIA firms. The state registers both RIAs and IARs.

The SEC and state securities regulators require registered investment advisor (RIA) firms to disclose settled and ongoing disciplinary history on their Form ADV. Item eleven (11) on Part I of the ADV specifically requires disclosure of certain criminal, regulatory and civil proceedings. The form also contains information about investment advisors and their business operations.

SEC regulated firms may limit the disclosure of any event to ten (10) years following the date of resolution. On the other hand, state registered firms may have to disclose beyond the ten year period. In reality, state registered firms may be held to a higher standard because they are generally required to disclose financial (judgments & liens), arbitration and civil proceedings as well.

Many RIA firms overlook the fact that in addition to the firm's history, **the history of affiliates must also be disclosed, including partners, directors, non-clerical employees and other controlled persons.**

Disclosure events are considered material and as a result, the ADV is to be updated promptly, usually within 30 days.

While RIAs are required to "offer" a copy of their Form ADV Part II to all their clients on an annual basis, Part I of their publicly disclosed ADV can be viewed on the SEC's Investment Advisor Public Search website.

The SEC search database available to the "public" was limited to RIA firms in the past, but i**nformation on individuals registered with the SEC and the states will be available in mid-2010**. The database will not, however, include those exempt from registration, unapproved applications or those who have not filed through the electronic IARD system.

The SEC's Investment Advisor Public Search website is located at:
http://www.adviserinfo.sec.gov/IAPD/Content/IapdMain/iapd_SiteMap.aspx .

For other SEC enforcement action, visit: http://www.sec.gov/divisions/enforce.shtml.

NASAA

State securities regulators were protecting investors long before the creation of the SEC and FINRA. Organized in 1919, the North American Securities Administrators Association (NASAA) is the oldest international organization devoted to investor protection.

NASSA is a voluntary organization whose members consist of 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, Canada and Mexico.

The public may not realize it and while it is still a work in progress, investors are protected by federal agencies, self-regulatory organizations, credentialing organizations and the states working in a collaborative manner.

Given that the SEC's public website search was limited to RIA firms in the past, the **Investment Adviser Public Disclosure Individual System (IAPD) upgrade, an online disclosure system similar to FINRA's BrokerCheck, is an important development.**

The NASAA system will provide the public with a national database devoted to the disclosure of information for advisors registered with the SEC and the various states. Prior to the launch of the upgraded IAPD, investors had to check with individual state regulators to get disclosure information.

With less than 80% of their jurisdictions reporting, NASAA's website indicates that more than 8,000 enforcement actions (administrative, civil & criminal) were initiated during the three years ending in 2007.

To contact the appropriate State Securities Regulator, NASAA's website may be visited at:
http://www.nasaa.org/QuickLinks/ContactYourRegulator.cfm.

NAIC

Founded in 1871, the National Association of Insurance Commissioners (NAIC) is a voluntary organization of insurance regulators whose members consist of 50 states, the District of Columbia and the five U.S. territories.

A state regulator's primary responsibility is to protect the interests of insurance consumers. The NAIC helps regulators fulfill that obligation through shared objectives and the coordination of regulations applicable to multistate insurers.

Insurance agents are regulated separately by each state. Unfortunately, **there is no central database that collects complaints against insurance agents**. As a result, the state insurance sites are limited to an agent's name and licenses held, i.e., **background checks are not available.**

To contact the appropriate State Insurance Commission, the NAIC website may be visited at: http://www.naic.org/state_web_map.htm.

Database Upgrades

For the latest information regarding upgrades to the CRD and IARD as well as the public BrokerCheck and IAPD databases, see Chapter Seven.

CHAPTER NINE
Certifications/Designations

As the industry matures, becomes more competitive and advisors seek to distinguish themselves, **designations, credentials and association memberships have become key components of the sales, marketing and selection process for professionals.** It should, however, be noted that some of the most accomplished retirement plan advisors have not pursued designations because none are 100% applicable to what they do.

Unfortunately, **the terms Financial Analyst, Financial Advisor, Financial Consultant, Financial Planner, Investment Consultant, Wealth Manager, etc, are generic labels**. These titles may be used by financial service professionals who lack related designations. They may also be used by individuals who lack securities licenses.

While professional credentials are optional, **the requirements for obtaining designations & certifications vary widely** along with the monitoring process, ongoing CE requirements and applicable codes of conduct. As always, designations and/or **credentials are only as good as the individual's character.**

The industry is awash in a sea of credentials and some will no doubt consolidate. While **the designations of choice by retirement plan advisors are evolving,** they currently seem to be split between the **CIMA®** designation from the Investment Management Consultants Association (IMCA), the **AIF®** designation from fi360 and ASPPA's **QPFC** designation. The College for Financial Planning's **CRPS®** and PlanSponsor's **PRP** also have some traction with retirement plan advisors.

The Certified Financial Planner Board of Standards' **CFP®** designation is also popular with advisors who provide individual financial services. The American College's **ChFC** is probably the second most favored credential among advisors who provide individual financial services.

The Chartered Financial Analyst (CFA) is often considered the most prestigious and difficult to obtain investment related financial services credential. The academic requirements, including three years of coursework, are second only to those for CPAs. Pass rates vary by year, but fewer than 20% of the candidates pass all three of the six-hour exams within three years. While the CFA is not that common among retirement plan advisors, **a growing number of teams have expressed interest in having a staff member pursue the designation.**

While formal education and other recognized credentials should be considered as well, particularly accounting and legal, a brief description of the most popular designations earned by retirement plan advisors will follow. For a detailed list of the almost 100 financial service industry designations, please visit http://apps.finra.org/DataDirectory/1/prodesignations.aspx.

Investment Management Consultants Association

Established in 1985, The Investment Management Consultants Association (IMCA) provides investment consulting and wealth management credentials to approximately 3,000 members.

The Certified Investment Management Analyst (CIMA®), the IMCA's cornerstone, is an advanced certification that was designed specifically for investment consultants in 1988. Launched in 2007, the Certified Private Wealth Advisor (CPWA®) was designed for wealth management specialists providing services to high net worth clients.

The Certified Investment Management Consultant (CIMC®) was a self-study program that was merged into the CIMA® program in 2002. New applicants are no longer accepted, but approximately 400 designees are still supported.

The CIMA® certification must be renewed every two years and requires 40 hours of CE credit. 20 of the required CE hours may be provided by a variety of non-IMCA sources. All CE hours must be processed by IMCA. To maintain the certification, the signed disclosure and payment must be submitted before the designation renewal expiration date.

Fi360

While investment specialists often pursue hours of technical training, little time has been devoted to developing the expertise applicable to fiduciary standards of care in the past. Given the recent cases claiming fiduciary negligence as well as an evolving regulatory environment, awareness of fiduciary responsibility is continually growing.

Fi360 offers a full circle approach to investment fiduciary education, practice management and support. The firm's professional designations cover a comprehensive investment process, related fiduciary standards of care and a commitment to excellence.

Since 2002, **the Accredited Investment Fiduciary (AIF®) has often been viewed as "the standard" for fiduciaries.** In response to a need for fiduciary assessment training, the Accredited Investment Fiduciary Analyst (AIFA®) was introduced in 2006. The AIF® is by far the more popular designation. On a combined basis, approximately 4,000 professionals have been certified by fi360.

Designees must renew annually. The AIF® requires 6 hours of CE credits while the AIFA® requires 10 hours.

ASPPA

Founded in 1966 as an actuarial organization, The American Society of Pension Professionals & Actuaries (ASPPA) has become a national organization for career retirement plan professionals. Members include administrators, actuaries, advisors, attorneys, accountants and other professionals who provide services to employer sponsored retirement plans.

The non-profit professional organization acts on behalf of their 6,000+ members to improve the nation's private pension system. ASPPA offers extensive educational opportunities and their Government Affairs department monitors legislative and regulatory activities. Over 5,000 members have earned more than 7,000 credentials, mostly in the administrative area.

ASPPA offers four primary credentialing tracks, supporting seven different credentials & two certificate programs, for retirement plan specialists. While additional credentials are also available, **the QKA, QPA and CPC are by far the most popular designations held by members.**

The "Plan Administration, Compliance & Consulting Track" supports the QKA, QPA and CPC designations. The "Financial Consulting Track" supports **the QPFC designation, the most common ASPPA designation among retirement plan advisors.** The "Tax-Exempt & Governmental Plan Administration, Compliance & Consulting Track" supports the TGPC designation. The "Actuarial Consulting Track" supports the MSPA and the FSPA designations.

To maintain ASPPA credentials, designees must earn 40 hours of investment or employee benefit related CE credits during their two year cycle. Going forward, the CE requirement must include 2 hours on Ethics or Professionalism. While non-ASPPA Sponsored Programs may be used to satisfy 100% of the CE requirements, there is a limit of 15 credit hours per non-ASPPA program. ASPPA does not pre-approve CE sponsors, but the content must be relevant to the industry.

CFP Board

The Certified Financial Planner (CFP®) designation is probably the most widely recognized credential in the financial planning industry.

The program is administered by the Certified Financial Planner Board of Standards, Inc. (CFP Board), a non-profit regulatory organization actively engaged with their 60,000 CFP® certificants.

Certificants are required to complete 30 hours of CE during a two year reporting period ending the day of individual's renewal month. While 28 hours may be earned from a variety of sources and topics listed on the Board's *Subject Topics Accepted for CE Credits*, two hours must be earned from pre-approved courses specific to the Board's *Code of Ethics* or *Practice Standards*."

College for Financial Planning

The College for Financial Planning (College) offers six professional designation programs spanning the asset management, retirement, mutual fund and financial planning sectors. The designations include the AAMS®, AWMA®, CMFC®, CRPC®, CRPS® and RP®. **The Chartered Retirement Plans Specialist (CRPS®) is the most relevant to retirement plan advisors.**

The College does not maintain a list of pre-approved continuing education sponsors and their courses. It is each designee's responsibility to obtain CE credits from a credible source whose programs meet the standard set forth in the College's *Professional Designation Requirements* document.

CE credits may emanate from a wide variety of sources and delivery methods. Conference sessions must address the College's Subject Topic Lists for CE Credit applicable to the different designations. Renewal is every two years and 16 CE credits must be met by the designee's expiration date which is based on when they earned their credential.

The American College

The non-profit American College has a rich history in the financial services education arena. Since the creation of the first financial designation in 1927, The Chartered Life Underwriter CLU®, more than 150,000 financial professionals have earned designations at the American College.

The American College offers a wide variety of leadership, specialized and fundamental programs, including the CLU®, ChFC®, CASL®, CLF®, CAP®, REBC® and RHU®.

The Chartered Life Underwriter CLU® and the Chartered Financial Consultant ChFC® are by far the most popular of their designations among advisors. These two designations require more coursework than the CFP®, but they do not require a comprehensive exam.

As a competing organization, the American College introduced the ChFC® in 1982 as an alternative to the CFP®. The CLU® is widely viewed as the industry's most respected insurance designation and has been pursued primarily by agents specializing in life insurance applications for business and estate planning.

Like the College for Financial Planning, the American College does not maintain a comprehensive list of pre-approved continuing education sponsors and their courses. It is each designee's responsibility to obtain CE credits from credible sources whose subject matter is acceptable to PACE (Professional Achievement in Continuing Education) Recertification.

While the required CE credits vary by designation, renewal is every two years and the credits must be earned by the designee's expiration date which is based on when they earned their credential.

IBF

Founded in 1988, The Institute of Business & Finance (IBF) offers five of the oldest financial designation programs in the industry.

More than 13,000 members of the financial services industry have completed one or more of their programs, including numerous Fortune 500 Companies. **The IBF's flagship Certified Fund Specialist (CFS®) is the fourth oldest designation in the industry and THE oldest mutual fund designation.**

Renewal is annual and 30 CE credits must be earned by the designee's expiration date which is based on when they earned the credential. All the credits can be non-IBF, but they must comply with IBF guidelines.

NIPA

The National Institute of Pension Administrators (NIPA) is a national association representing the retirement and employee benefit plan administration profession.

Founded in 1983, the 800 member organization designs, implements and administers programs for the benefit of members, the industry and the public. NIPA is also a provider of education programs for retirement plan professionals.

Designed for pension administrators, relationship managers and ERISA compliance specialists, the Accredited Pension Administrator (APA) provides insight into the daily administration of retirement plans.

Designed for financial consultants/planners, retirement plan personnel and RIAs, the Accredited Pension Representative (APR) provides a general survey of all retirement plan types and engages in advance design.

The APA requires 15 hours of annual CE and the APR requires 10. Multiple designations require a combined 15 hours of CE. CE credits can be earned from a variety of sources, including non-NIPA sponsored programs. 100% of the CE requirements can be obtained from non-NIPA sources. Renewal is annual and the CE credits must be earned by July 1st of the expiring year.

SPARK, CFA Institute, Financial Service Standards & PRP

Details to follow.

CHAPTER TWELVE
Fiduciary Liability, E&O Insurance & Affirmative Coverage

Most small plan sponsors lack fiduciary liability insurance and while they may not realize it, **most advisors lack E&O coverage for fiduciary services provided to ERISA plans.** In addition to little if any licensing, CE and net worth requirements, small RIA shops may not have ANY insurance. Non-specialized insurance brokers who sell E&O coverage have added to the confusion and contributed to the inadequate coverage.

While ERISA does not require the insurance coverage, sponsors and advisors are often confused about the differences between Fiduciary Liability Insurance & E&O Insurance as well as the differences between first and third party policies.

First party insurance is purchased directly by an individual or company who may be impacted by a loss while third party insurance is purchased by an individual or an entity providing services to a third party.

Fiduciary Liability Insurance is an example of first party insurance and E&O Insurance is an example of third party insurance. First party Fiduciary Liability Insurance is NOT purchased by advisors.

Fiduciary Liability Insurance For Sponsors:

Fiduciary Liability Insurance is purchased to protect plan sponsors, named fiduciaries and other functional fiduciaries with a DIRECT relationship to the plan from claims alleging a breach of fiduciary duties.

Fiduciary liability insurance covers all the sponsor's ERISA plans, including health & welfare plans. This is important because more than half of all claims are unrelated to retirement plans.

In addition to claims alleging a breach of fiduciary duties, the insurance covers:

- Negligent Errors & Omissions
- Improper Disclosure To Plan Participants
- Remiss Investment Advice
- Imprudent Choice Of Outside Service Providers
- Faulty Advice Of Counsel
- Improper Amendments to Plan Documents

While "named fiduciaries" are listed in the plan document, fiduciary status may also be defined by functional roles. As a result, individuals may become fiduciaries without knowing it. Fiduciary status has been the subject of endless debate, but fiduciaries are generally defined as any person who:

- Exercises discretionary authority or control in managing the plan or the disposition of plan assets.
- Renders investment advice for a fee or compensation with respect to funds or property belonging to the plan.
- Has discretionary authority or responsibility for plan administration.

The individuals insured under first party fiduciary liability insurance generally include those who are directors, officers, governors, trustees, equivalent executives, employees, committee members, etc. The lawful spouse as well as the estate, heirs, legal representatives or assigns of a deceased fiduciary may also be covered for wrongful acts of the insured.

While possible, **advisors and other third-party fiduciaries are rarely added to the plan sponsor's first party fiduciary liability insurance policy.** In the rare situations where third parties are added to the sponsor's policy, relief would require both parties to be named in the suit and the third party reimbursement may be limited to defense costs.

Adding a third party, investment advisor, TPA or other professional to the plan sponsor's policy is not recommended because first party policies are only designed to cover the exposures and personal assets of named fiduciaries. If the third party was negligent, the sponsor's policy would have to respond and the sponsor's policy limits would be eroded.

Going beyond first party fiduciary liability insurance, **the plan sponsor's due diligence should ensure that outside vendors have the proper professional liability insurance** in place. The due diligence should further **ensure that the policy provides coverage as a fiduciary for the services rendered to the sponsor and their ERISA plan.**

As noted, plan sponsors rarely add third parties to their first party policies. Similarly, plan sponsors rarely purchase third party coverage for others and when they do, plan assets should NOT be used to purchase the insurance.

Why Fiduciary Liability Insurance & What To Look For

Fiduciary claims against plan sponsors have increased significantly and half of all claims receive awards. Small companies also have a one in twelve chance of a claim. Nevertheless, fiduciary liability insurance is not required and as a result, **most small plan sponsors self-insure fiduciary risk with personal and corporate assets.**

Regardless of the creativity surrounding new retirement plan sales approaches, **named fiduciaries cannot escape ALL their fiduciary responsibilities and personal liability**. Given the litigious environment and the low cost of fiduciary liability insurance, **plan sponsors who fail to obtain the appropriate insurance coverage are foolishly exposing themselves to unnecessary risk**.

As noted, fiduciary liability insurance is not expensive and in addition to helping sponsors obtain the coverage at a discount, an expert retirement plans advisor could help sponsors review their coverage. Some of the issues to consider include:

- Insurance Carrier Quality
- Policy Coverage, Named Insured & Wrongful Act Definitions
- Limits & Deductibles
- Shared Limits (Attached To A Director Or Officers Policy) Vs. Stand Alone Fiduciary Limits
- Ability To Report An Incident (Non-claim)
- Review Of Exclusions & Added Endorsements
- Ability To Alter Or Make Changes In Coverage

Although ERISA does not require plan sponsors to purchase fiduciary liability insurance, **sponsors who use plan assets to defend themselves from claims could be breaching their fiduciary duties.** In addition, the facts of the litigation are not subject to attorney client privilege when plan assets are used to pay the premium.

Given that the majority of E&O policies do not provide affirmative fiduciary coverage, **sponsors who hire advisors without adequate insurance may also be breaching their fiduciary duties.**

Professional Liability Insurance For Investment Advisors:

Errors & Omissions (E&O) Insurance is a professional liability type of insurance for investment advisors, consultants and other service providers.

The E&O Insurance policy protects advisors and consultants against losses due to any actual or alleged negligent act, error or omission committed in the scope of their duties as investment advisors or consultants.

Professional liability insurance is available for a number of different types of investment advisors and consultants, including: Investment Advisors, RIA's, Registered Representatives, Investment Consultants, TPAs, Recordkeepers, Trustees, Broker-Dealers, Pension Consultants, Litigation Consultants and Actuaries.

E&O Insurance is important because **one out of seven professionals will be named in some type of claim** at some point in their career. Even when unwarranted, lawsuits are expensive to defend. **The costs could bankrupt a smaller company or individual** as well as have a lasting impact on the bottom line of larger companies.

E&O Insurance policies are unique and they contain widely varying coverage and exclusions. In many cases, the insurance is also product-line specific. In general, the insurance helps pay for defense costs and damage awards. These policies have specific limits and usually include legal costs and damage awards in a single limit.

Because E&O Insurance is a specialty area, these policies should be reviewed by independent insurance brokers who specialize in E&O Insurance and have industry specific knowledge. **The policy should cover the specific professional services provided.** Advisors often shop for cheaper policies and it is important to note that lower priced policies often exclude these professional services.

Increased Scrutiny & The Need For Clarity

ERISA attorneys who assist plan sponsors with their RFP's and compliance reviews are becoming a driving force behind investment advisors seeking clarity on their insurance coverage. Unlike the past, **proof of insurance coverage can no longer be satisfied by a simple Certificate of Insurance (COI).**

The COI could state proof of affirmative coverage for fiduciary acts, but that requires the agent to read and understand the policy. If they are uncomfortable interpreting the policy, the agent would have to go back to the carrier for approval. As a result, sponsors and their attorneys are increasingly asking to review the full policy, including all endorsements. The purpose of the review is to **ensure the advisor has fiduciary coverage for the services rendered to their plan as well as the mandated third party ERISA Investment Bond applicable to discretionary authority.**

The EAE's detailed RFP service for vetting the advisor's E&O policy is beyond the scope of this guide, but note that attorneys generally include fiduciary services coverage, limits, deductibles, exclusions and added endorsements when reviewing a policy. In addition to fiduciary exclusions, **contractual exclusions carving out 3(21) & 3(38) activities could apply.**

Additional questions on lawsuits, outcomes, fines, censure, disciplinary actions, audits, designations, certifications, independence and lost clients are also appropriate.

Many professionals believe they have the appropriate insurance coverage for the services they provide when in fact they don't. As a result, **expert retirement plan advisors are raising the bar on their competitors by proactively reviewing their policies and presenting a COI with proof of affirmative insurance coverage upfront.**

The Adequacy Of Coverage & Exclusions

The only way to determine if an E&O policy provides adequate coverage for the advisor - and the entity - is to have a "legitimate expert" read the policy, including all endorsements, and compare the coverage to the services offered.

As noted, E&O policies vary widely and **they often contain coverage restrictions and contradictory clauses on policy coverage intent.**

The most common methods for writing policies are:

- Absolute ERISA Exclusion
- Silent on ERISA Coverage
- Limited ERISA Coverage
- Affirmative ERISA Coverage

Affirmative ERISA coverage is obviously the preferred path. With or without amendments**, a covered act should be defined as a "fiduciary act by the advisor."** The definitions may also have to be amended to include administration, benefits and actual as well as alleged fiduciary acts.

B-D Policies & RIA Activities

Broker-Dealer E&O policies for RIA activities vary widely. Historically, B-D policies excluded or limited coverage for acts as a fiduciary when performing services for ERISA plans, but this coverage is evolving. On the other hand, large B-Ds have the financial capacity to stand behind indemnification gone wrong.

The RIA coverage may be limited to the individual and not cover the advisor's entity. Some B-D policies also exclude services not approved or offered through the B-D. For clarification purposes, portability, prior acts coverage, aggregate policy limits, coverage for services outside the B-D, RIA activities and entity coverage should all be reviewed.

Large B-Ds generally require their affiliates to buy their E&O coverage through the firm. **The B-Ds policy is not always available for review and the carrier may be reluctant to provide concrete evidence of fiduciary coverage.** Independent RIA's & IAR's who are not classified as employees may, however, purchase separate coverage to rectify any deficiencies.

Policy Review:

Given the litigious environment and the low cost of fiduciary liability insurance, we have already noted that plan sponsors who fail to obtain the appropriate insurance coverage are foolishly exposing themselves to unnecessary risk. To remain competitive and stay in the game, retirement plan advisors should also clarify their coverage for fiduciary acts and be prepared for expanded vetting of their policies.

In addition to increased class action litigation against employers and the expanded financial exposure posed, fiduciary breach claims and settlements have jumped sharply. In summary, **the lack of adequate E&O insurance coverage for fiduciary acts will accelerate the consolidation of advisory services and drive the uninsured out of the retirement plans business.**

To have policies reviewed or obtain coverage, sponsors, advisors, ERISA attorneys, RIAs, consultants and B-Ds may contact the CFDD's resource contributor on E&O Insurance. **Sponsors and advisors using the EAE Program may obtain the appropriate coverage at a significant discount** For more information on fiduciary liability insurance and E&O coverage for ERISA plan advisory services, contact:

Gary Sutherland, CEO
North American Professional Liability Insurance Agency, LLC
5 Whittier Street, 4th Floor
Framingham, MA 01701
Phone: (866) 262-7542
Fax: (508) 656-1399
Email: GaryS@Naplia.com
Web: http://www.naplia.com

RESOURCES:

CFDD Litigation Update
Marcia Wagner, Managing Director, The Wagner Law Group, PC
http://www.thecfdd.com/monitorlitigation

401(k) Fee Litigation Update
Groom Law Group
http://www.groom.com/resources-446.html

ERISA Class Action Settlements
Fiduciary Counselors Inc.
http://www.erisasettlements.com/main.htm

ERISA Litigation By Circuit
PensionLitigation.Com
http://pensionlitigationdata.com/dynamiclist.php?PageId=60&PageSubId

DOL Criminal Enforcement
http://www.dol.gov/ebsa/newsroom/criminal/main.html

Workplace Class Action Litigation Report
Seyfarth Shaw LLP
http://www.seyfarth.com/ClassActionReport

CHAPTER THIRTEEN:
ERISA Bonds & ERISA Investment Bonds

An ERISA Bond is an amended Fidelity bond that meets the requirements of ERISA law. Unlike a Fidelity Bond, which pays losses to the insured, an ERISA Bond **pays losses directly to the client** whose assets are managed. It has no deductible, calculates limits on plan assets up to $500,000 and is specific to each plan.

The bonding requirements are **designed to protect employee benefit plans from the risk of loss due to fraud or dishonesty** on the part of persons who "handle" plan funds or other plan assets. ERISA Bonds do not protect plan fiduciaries from breaches of their fiduciary duties.

In a typical bond, the plan is the named insured and a surety company is the party that provides the bond. Bonds must be placed with surety a company or reinsurer that is named on the Department of the Treasury's Listing of approved Sureties.

Unlike the optional first party Fiduciary Liability Insurance and E&O Insurance, **ERISA Bonds and ERISA Investment Bonds are required.** Unless exempted (banks, insurance companies & Registered B-Ds), section 412 of ERISA states that every fiduciary of a funded employee benefit plan and person who "handles" funds or other property of the plan are required to be bonded.

Based on direct interface, the DOL acknowledged that section 412 is confusing and not worded well. Nevertheless, their intentions are clear in that **every fiduciary and any other person who "handles" funds must be bonded.** In other words, being an ERISA fiduciary alone does NOT mandate bonding.

In addition to the ERISA Bond requirements for plan officials, investment **advisors and other service providers who exercise control over plan assets and/ or make investment decisions for ERISA plans are required to maintain an Investment Advisor ERISA Bond.**

A person who provides investment advice, but does not exercise, or have the right to exercise, "discretionary" authority with respect to buying or selling plan assets is not, however, required to be bonded solely by reason of providing such investment advice.

The term "handling" carries a broader meaning than just physical contact with plan funds or property. In other words, **a person is deemed to be "handling" funds or property when their duties or activities carry a risk that the funds could be lost in the event of fraud or dishonesty,** whether acting alone or in collusion with others.

When defining "handling," the power to transfer funds, disbursement authority, authority to sign checks, supervisory or decision-making responsibility over activities that require bonding, fiscal controls, the closeness of supervision and who has final responsibility for disbursements must all be considered.

Investment ERISA Bonds

The issue over who is required to be bonded comes up frequently. Professional opinions vary widely and many advisors feel they are exempt from bonding requirements because they do not "handle" or custody assets.

On the other hand, insurance and legal experts have concluded that **advisors who have ANY ability to commit fraud or dishonest acts against their ERISA plan clients are REQUIRED to be bonded.** This includes the ability to withdraw advisor fees directly from the plan, contact with the custodian, recommendations to move the funds and any other potential for forgery.

The aforementioned insurance experts estimate that the majority of advisors and/or their employees have some ability to commit fraud or dishonest acts against their ERISA plan clients. Given that the unscrupulous rarely ask for approval, they further believe that **plan sponsors who allow outside vendors to service their plans without the required bonding may be breaching their fiduciary duties.**

Advisors with the proper bonding may have a marketing edge, but some very accomplished retirement plan advisors **recommend against allowing any fee withdrawal flexibility on the part of advisors and structure their advisory agreements accordingly.**

One thing seems certain, **investment professionals with access to plan funds in any way are required to purchase a bond from an approved insurance company.** The amount of the bond is 10% of the plan's assets up to the maximum of $500,000 for each qualifying plan without company stock. Plans with company stock require a $1 million bond.

These bonds can be written on an individual basis, where each plan is identified, or as a blanket bond covering all plans. A blanket bond would include any new plans added after the policy effective date and each year the application would capture all the current plans.

In short, an RIA with twenty-five plans would have a bond that covers each client's plan that is based on the assets of their plans. Additionally, **some plans may require them to carry a scheduled bond that specifically names just THEIR plan and the amounts could be much higher than the 10%.**

Broker-Dealer Exemption:

Section 412(a)(2) of ERISA, as added by the Pension Protection Act of 2006, provides an exemption from the bonding requirement for an entity which is registered as a broker or a dealer under Section 15(b) of the Securities Act of 1934, provided that the broker or dealer is subject to the fidelity bond requirements of a self-regulatory organization within the meaning of the 1934 Act.

The aforementioned exemption applies to the broker-dealer entity and its officers, directors and employees. (See DOL Field Assistance Bulletin No. 2008-4, Q&A 15.) Based on the exemption and home office support, many dually registered IARs believe they are exempt from the ERISA Investment Bond requirements , but we do not believe that to be accurate.

In light of the purpose of the bonding requirement, which is to protect plan assets from the dishonesty of a person with discretionary authority over such assets, we have concluded that the broker-dealer exemption is limited to the employees, officers and directors of the broker-dealer that have already afforded such protection to the plan through another bond. This has always been a gray area, but **unless the IAR is a W-2 employee and uses the B-D's RIA, we do not believe they are exempt from the ERISA Investment Bond requirement.**

Bonding Responsibility

The responsibility for ensuring that plan officials are bonded may fall upon a number of individuals simultaneously. In addition to a plan official being directly responsible for complying with the bonding requirements in section 412(a) of ERISA, section 412(b) specifically states that **it is unlawful for any plan official to permit any other plan official to receive, handle, disburse, or otherwise exercise custody or control over plan funds or other property without first being properly bonded** in accordance with section 412.

Furthermore, section 412(b) makes it unlawful for "any other person having authority to direct the performance of such functions" to permit anyone to perform such functions without being bonded. Thus, by way of example, if a named fiduciary hires a trustee for a plan, the named fiduciary must ensure that the trustee is either subject to an exemption or properly bonded in accordance with section 412, even if the named fiduciary is not required to be bonded, because they do not handle plan funds or other property.

Plan officials may purchase ERISA bonds with plan assets, but they are under no obligation to purchase the ERISA Investment Bonds applicable to advisors and other third parties. **Service providers generally purchase their own separate bond insuring the plan and add it to the cost of their service.**

For an additional layer of protection, **plan sponsors should consider requiring all third party vendors that "handle" plan funds to provide a copy of a current in force ERISA Bond with the individual plan named as the indemnitee.**

For more information on ERISA Bonds, visit the DOL's website located at:
http://www.dol.gov/ebsa/regs/fab2008-4.html.

CHAPTER FOURTEEN:
Employee Dishonesty Insurance

We have already discussed fiduciary liability insurance for plans sponsors, E&O Insurance for advisors, ERISA Bonds for plan sponsors and ERISA Investment Bonds for advisors & other third party service providers.

The last component of the full suite consists of Employee Dishonesty Insurance, coverage that can be purchased by employers and advisors to **protect non-ERISA funds from theft.** Before discussing Employee Dishonesty Insurance, let's briefly summarize the different coverage mentioned above.

- ***Fiduciary Liability Insurance For Sponsors:*** Fiduciary Liability Insurance is purchased by an individual or company to protect plan sponsors, named fiduciaries and other functional fiduciaries with a "direct" relationship to ERISA plans from claims alleging a breach of fiduciary duties. Unlike ERISA Bonds, the first party insurance is optional.

- ***E&O Insurance For Advisors & Consultants:*** Errors & Omissions (E&O) Insurance is a professional liability type of insurance for investment advisors, consultants and other service providers. The policy may be purchased by the individual advisor or their firm. Advisors may also purchase supplemental coverage. The E&O Insurance policy protects advisors and consultants against losses due to any actual or alleged negligent act, error or omission committed in the scope of their duties as investment advisors or consultants. Registered reps and captive insurance agents are not required to have E&O coverage, but most B-Ds and insurance companies with coverage require their reps to be covered. Independent RIAs may have coverage, but they are not required to maintain an E&O policy.

- ***ERISA Bonds For Plan Sponsors:*** An ERISA Bond is an amended Fidelity bond that meets the requirements of ERISA law. Unlike a Fidelity Bond, ERISA Bonds pay losses directly to the client whose assets are managed. ERISA Bonds are designed to protect employee benefit plan assets from the risk of loss due to fraud, dishonesty or theft on the part of plan officials who "handle" plan funds or other plan assets. While plan sponsors must purchase ERISA Bonds, they do not protect plan fiduciaries from breaches of their fiduciary duties.

- ***ERISA Investment Bonds For Advisors & Third Party Service Providers:*** ERISA Investment Bonds are designed to protect employee benefit plans from the risk of loss due to fraud, dishonesty or theft on the part of third party service providers who "handle" plan funds or other plan assets. While third party service providers, including advisors & their employees, who have access to plan funds are required to purchase ERISA Investment Bonds, they do not provide E&O type coverage.

- ***Employee Dishonesty Insurance For Employers & Advisors:*** Employee Dishonesty Insurance, sometimes called crime coverage, employee dishonesty bond, fidelity bond & crime fidelity insurance, can be purchased by employers and advisors to protect non ERISA funds from theft. When purchased by an employer, the company is protected from losses due to employee theft, burglary and destruction. When purchased by an advisor, clients are protected from losses due to theft by the advisor and/or their employees. Employee honesty insurance is optional, but some B-Ds require their reps to carry this insurance.

Why Employee Dishonesty Insurance

This is a guide about evaluating retirement plan advisors and while it can be purchased by both parties, Employee Dishonesty Insurance is purchased by employers to protect them from financial loss due to fraudulent activities on the part of employees or a group of employees. Employers are also protected from loss due to burglary and destruction. Given the rise in workplace fraud and embezzlement, employers should consider this coverage.

In addition to the rise in crime mentioned above, the Madoff era of fraud has intensified the scrutiny of financial professionals. Indeed, the majority of clients who terminate their personal advisory relationship mention trust as one of the key reasons.

Advisors who only provide plan level services may not need Employee Dishonesty Insurance. However, **advisors, including team members, who cross-sell to retirement plan participants and other employees should have this coverage.** While some B-Ds require their reps to carry this coverage, large advisory clients may require higher limits as well as limits dedicated to their individual exposure.

The devil generally lurks in the details and as the advisor selection process becomes professionalized, **advisors with the full suite of coverage below will clearly have a marketing edge.**

- E&O Insurance With Affirmative Fiduciary Coverage For The Advisor & Their Entity That Is Free Of All ERISA Exclusions
- ERISA Investment Bond
- Employee Dishonesty Insurance

Many advisors who have left their B-Ds and set up their own practice have dropped their E & O Insurance. In short, they fail to realize that **advisors who lack adequate insurance coverage and bonding will be the first to be eliminated from the RFP process by knowledgeable plan sponsors.**

CHAPTER FIFTEEN:
Advisors & ERISA Fiduciary Roles

Like most small plan sponsors, many advisors are unaware of their fiduciary responsibilities under ERISA while others ignore them. Additionally, **many advisors are unwilling or unable to acknowledge their ERISA fiduciary status.**

Some advisors will acknowledge their fiduciary status on a functional basis, but will not put it in writing. The industry has often used the "Fiduciary" term for marketing and while a limited number of advisors will acknowledge fiduciary status in writing, their advisory contracts may be structured to limit liability.

Contrastingly, **a select group of retirement plan experts will acknowledge their ERISA fiduciary role and responsibilities in writing via an appropriate contract.** A sub-set group will accept additional liability for discretionary investment control and others may be willing to accept an even broader fiduciary role. As noted many times, **the acknowledgement of an ERISA fiduciary role is of little or no value if the advisor is not competent, qualified and experienced.**

While the fiduciary status of advisors remains unsettled, it has a significant impact on retirement plans, sponsor liability, claims, conflicts and prohibited transactions, including self-dealing.

Small plan sponsors and non-specialists generally lack knowledge of the fiduciary duties and responsibilities imposed by ERISA, but confusion surrounding the various fiduciary roles is also common among highly skilled professionals.

This confusion underscores the need for clarification of the distinctions between the different fiduciary roles applicable to advisors and how they impact an advisor's practice as well as the services they render to a plan sponsor.

Fiduciary Basics

Before discussing the more sophisticated nuances of the different fiduciary roles advisors could assume, it's worth noting that many fail to grasp the basic differences between a "named fiduciary" and other fiduciary roles.

To clarify, individuals become fiduciaries through appointment or function. **The "named fiduciary" is the individual, committee or entity specifically appointed and identified in the plan document or pursuant through a procedure specified in the plan document.** Although the "named fiduciary" retains authority to manage the plan, they may delegate their responsibilities to third parties, including non-employees.

Although possible, **advisors are rarely retained as "named fiduciaries**," a title more likely assumed by the employer or an officer of the employer and designated in the plan documents. In spite of this rarity, many service agreements acknowledge the advisor as a "named fiduciary," creating confusion for all parties to the agreement.

Many advisors, B-Ds and E&O carriers believe such acknowledgement makes the advisor a "named fiduciary," but that is not generally the case. Additionally, some advisors and B-Ds wrongly believe they are protected by the sponsor's fiduciary insurance coverage.

While some advisor service contracts state that a sponsor must indemnify advisors from fiduciary claims, exculpatory contractual provisions which purport to relieve a fiduciary from responsibility or liability are void against public policy. In other words, **a plan cannot indemnify a third-party fiduciary for their actions.**

In reality, sponsors rarely buy "third party" insurance coverage that indemnifies any fiduciary other than named fiduciaries or individuals "employed" by the plan sponsor to act in a fiduciary capacity. Knowledgeable insurance brokers are also adamant that **sponsors should NOT indemnify an outside advisor or entity.**

The Scope Of Fiduciary Roles

The terms "limited scope," "full scope" and others in between have recently become popular within certain fiduciary circles, particularly among those advocating a full scope "named fiduciary" role for advisors. While these topics have been the subject of moderate debate, they are NOT referenced in any statute or regulation. In other words, **what is becoming trendy industry nomenclature is not rooted in regulations or legislation.**

For the most part, individuals who endorse these titles have developed business models that adopt their favored position. These business models are just that, i.e., business models. They are neither right nor wrong and they have always existed within ERISA's framework.

In addition to the creative nomenclature, a commonality among those favoring the "full scope named fiduciary" approach for advisors is support for the multiple-employer plan concept, the elimination of the participant's discretionary control over their 401(k) account, a less than favorable view of the merits of ERISA section 404(c) and severe criticism of the "limited scope" approach. These views represent a minority position within a mature industry that embraces customization, participant control and risk management strategies.

The aforementioned views may have merit, but they represent one of many approaches. Advocates of "full scope named fiduciary" outsourcing and multiple-employer plans are based on eliminating the sponsor's fiduciary liability through delegation.

Advocates feel this delegation is a game changer, but others note that **the sponsor is almost always the primary target of litigation**. They further note that regardless of broad fiduciary delegation, **the sponsor's decisions, process and service providers remain subject to examination**. In short, while sponsors may limit their liability, they cannot eliminate it.

Fiduciary Distinctions

While fiduciary "missionaries" have drilled down to China in their attempts to identify & characterize distinctions, the "primary" fiduciary distinctions applicable to advisors are as follows:

- **Limited-Scope 3(21):** Someone who has been appointed by a "named fiduciary" with responsibility to render "non-discretionary" investment advice to the "named fiduciary" and/or participants. **The majority of advisors who acknowledge their ERISA fiduciary status operate as limited 3(21) fiduciaries**.

- **Discretionary 3(38) Investment Manager**: An appointed fiduciary who has full "discretion" for investment selection and monitoring. The presence of a 3(38) may relieve the "named fiduciary" from the liability for the investment selection and monitoring process, assuming the selection of the investment manager was prudent.

- **Full-Scope 3(21)**: Someone who has been appointed with the authority to hire/fire investment managers and/or service providers, generally the "named fiduciary" in the plan documents. Typically, most "named fiduciaries" retain this responsibility, but it could be outsourced. If the Full-Scope 3(21) has the skill set to act as an investment manager, they may do so or appoint a 3(38) investment manager. They may also provide investment advice to the "named fiduciary," participants or the investment manager.

In summary, most advisors who accept fiduciary responsibility under ERISA operate as Limited-Scope 3(21) fiduciaries and some have no doubt used the fiduciary word as a marketing tool. A smaller group is willing to assume a 3(38) Investment Manager fiduciary role to distinguish themselves and an even smaller group is marketing the Full-Scope 3(21) "go to" approach in lieu of the 3(38) role.

In a market dominated by look-through investments and participant direction, skilled advisors who operate as "legitimate" Limited Scope 3(21) fiduciaries question the demand and need for the broader fiduciary delegation. Additionally, while plan sponsors could do it, they wonder why any plan sponsor would want to delegate full authority to hire/fire service providers.

Skeptics of the broader delegation are willing to accept a Limited-Scope 3(21) fiduciary role for the advice provided and acted upon, but they are NOT willing to accept liability for breaches beyond their control. While they acknowledge the difference between the various fiduciary distinctions, they do not believe one is inherently superior to the other. They also question whether the multiple-employer plan approach with a Full-Scope 3(21) that exercises discretion to hire/fire service providers would prevail under scrutiny.

Advisors marketing themselves as 3(38) Investment Managers often note that they are providing plan sponsor insulation by assuming liability for discretionary investment control. This can certainly be accomplished via ERISA 3(38), but others note that the plan fiduciary's task of "monitoring" the investment manager is no easy task. In fact, they believe it is more difficult than working with an investment advisor. While they acknowledge the delegation might provide additional defense in the event of a lawsuit, they also believe that it could be used as the catalyst to prove plan fiduciaries were imprudent and negligent.

When a plan level "named fiduciary" outsources their fiduciary role to a Full-Scope 3(21) fiduciary who plans to appoint an additional 3(38) fiduciary, **sponsors should be mindful of the added costs associated with this broad delegation of fiduciary duties, including the need for ERISA Investment Bonds.** Sponsors would also be wise to perform due diligence on the relationship between 3(21) and 3(38) fiduciaries as well as any multiple-employer plan arrangements**.**

Advocates of the Full-Scope 3(21) approach downplay the importance of monitoring the outsourced fiduciary, but **any decision to delegate responsibility requires serious monitoring through some sort of annual audit or re-certification process.**

Fiduciary distinctions are important, but they are only "one" component of the advisor evaluation process. Like most things in life, there is rarely one best approach or right way to do things. As a result, **plan sponsors should be receptive to effective solutions that support their objectives.**

In addition to possessing the skill set to meet their objectives, the advisor selection process should be based on knowledge, experience, dependability, objectivity and deliverables. In short, **an inexperienced advisor willing to assume an ERISA fiduciary role is not a viable solution.**

In summary, plan sponsors should:

- Understand Their Fiduciary Role
- Maintain The Required ERISA Bond & Optional First Party Fiduciary Liability Insurance
- Clarify The Fiduciary Role & Responsibilities Assumed By Their Advisor
- Pursue Strategies That Meet Their Objectives
- Demand Proof Of Affirmative Fiduciary Coverage, ERISA Bonds For Discretionary Authority & Employee Dishonesty Coverage For Non-ERISA Funds
- Read The Service Agreement & Avoid Indemnifying Third Parties For Their Responsibilities
- Never Insure A Third Party Fiduciary As Part Of Your Policy
- Add Outsourced "Named Fiduciaries" As An Addendum
- Understand/Evaluate The Fees Associated With The Different Fiduciary Approaches, Including The Appointment Of Full Scope 3(21) & 3(38) Fiduciaries
- Avoid Generalists & Advisors Willing To Assume A Fiduciary Role Without Knowing The Scope & Nature Of The Project
- Be Skeptical Of Sales Approaches Centered On The Removal Of Fiduciary Liability

CHAPTER SIXTEEN
Outsourcing Fiduciary Responsibility

As noted in the Preface, the majority of advisors serving retirement plans are not specialists. They are also unable or unwilling to acknowledge their fiduciary status under ERISA. Some *Non-Fiduciary Advisors* will acknowledge their fiduciary status on a functional basis, but will not acknowledge it in writing.

As the industry matures, an increasing number of advisors are now willing to acknowledge their non-discretionary *Limited-Scope 3(21) Fiduciary* status for investment advisory services. A sub-set of advisors will accept additional liability for discretionary investment control as *3(38) Investment Managers.* A far smaller number of advisors are willing to accept an even broader named fiduciary type of role as a *Full-Scope 3(21) Fiduciary.*

Most advisors who accept fiduciary responsibility under ERISA function as a *Limited-Scope 3(21) Fiduciary.* On the other hand, a growing number of advisors are representing themselves as *3(38) Investment Managers* as part of their value proposition. Very few plan sponsors appoint advisors as *a Full-Scope 3(21) Fiduciary.*

Trends & Liability

Like any industry, **retirement plan advisory skills and experience vary widely**. While skilled advisors may be qualified to function in a variety of fiduciary capacities, the majority of advisors are not qualified to service ERISA retirement plans. It is also important to note that a qualified 3(21) Fiduciary advisor may not be qualified to serve as a 3(38) Fiduciary.

Based on trends and the opportunity to earn higher margins, the number of advisors marketing 3(38) investment management services has increased significantly. They may not realize it, but advisors marketing investment management services without the corresponding skills have increased their risk significantly. Correspondingly, **sponsors who outsource fiduciary responsibilities to unqualified advisors are also increasing their liability**.

This is an extremely important observation because advisors and plan sponsors who fail to meet ERISA's fiduciary standards for selecting and monitoring service providers will be increasingly vulnerable to monetary claims filed by plaintiff attorneys.

While sponsors were generally the target of litigation in the past, **advisors acknowledging their fiduciary status as 3(38) investment managers have quickly fallen into the cross-hairs as a primary target.** This dual target represents a sea of change for plaintiff attorneys, particularly when 3(38) advisors tout the availability of fiduciary insurance coverage.

Based on input from expert witnesses, **plaintiff attorneys are anxious for the opportunity to litigate plan sponsors and advisors marketing 3(38) investment management services with little or no experience and no documented track record.** Future market corrections will no doubt accelerate a litigator's interest in suing plan sponsors for retaining the services of unqualified advisors.

ERISA is serious business and the courts will eventually decide the level of due diligence that constitutes *prudence* on the part of plan sponsors when selecting a 3(38) investment manager and other fiduciaries, i.e., ERISA makes no distinction between fiduciaries. They will also define the *qualifications* required to serve as a 3(38) investment manager.

When Outsourcing Makes Sense

There are many reasons why a named fiduciary may want to delegate some of their fiduciary functions to a third party, including discretionary responsibility for managing plan assets. Many in-house fiduciaries simply lack the time and/or expertise to prudently exercise discretionary control over plan assets.

Using the services of a 3(38) Investment Manager would also be appropriate in situations that involve the management and or liquidation of imprudent investments where the plan sponsor has a potential conflict.

To obtain relief from investment management liability, a plan sponsor must, however, delegate all discretionary investment management control of the plan's assets to a qualified 3(38) fiduciary, not something most plan sponsors are willing to do.

Liability Relief

The attraction of a 3(38) investment manager to a plan sponsor is the anticipated fiduciary relief associated with outsourcing asset management responsibility to an independent third party expert. In addition, it assumes the 3(38) adheres to its investment mandate and delivers the expected results.

The sought after relief from liability may, however, be limited for several reasons. For example, the 3(38) may not be an expert, the mandate may not be followed and the expected results may not materialize. In each scenario, the plan sponsor retains liability for monitoring and holding the investment manager accountable.

With regard to monitoring, the plan sponsor is required to ensure the 3(38) has adopted a prudent process and methodology for meeting the plan and ERISA related requirements. The sponsor need not verify outcomes, but they must ensure the 3(38) has an appropriate process and diligently follows the process.

Other than ongoing monitoring, any **active participation in the decision making process by the plan sponsor could result in a resumption of liability for investment management decisions.** It could also cause the 3(38) to become a co-fiduciary and liable for the actions of the plan sponsor.

In practice, monitoring a 3(38) is somewhat problematic because the delegation implies disassociation from the decision making process while still maintaining responsibility for ensuring the 3(38) follows an appropriate process. In other words, how does the sponsor ensure the 3(38) is following a prudent process without reviewing the outcomes – and potentially testing them – thereby interfering in the decision making process?

Prudence: The Determining Factor

Based on needs and circumstances, there are situations where the hiring of a *qualified* 3(38) manager may make sense. While residual liability remains with the sponsor, a *prudently* selected 3(38) can shoulder the liability for investment management decisions and the results they control.

Contrastingly, **an *imprudently* selected 3(38) not only precludes the transfer of liability for investment related decisions, it increases the sponsors liability.**

Regardless of the intent, scope and/or terms of the service provider agreement, **in-house/named fiduciaries who delegate fiduciary responsibilities to others can never be completely relieved of their fiduciary responsibility or the personal liability** that comes with the role.

The plan's in-house/named fiduciary is always responsible for prudently selecting and periodically monitoring their service providers. To avoid a fiduciary breach, **sponsors must also terminate service providers when it is no longer prudent to engage them.**

CHAPTER SEVENTEEN
Advisor Service Agreements

Enormous attention has been centered on retirement plan fees in recent years, including the new 408(b)(2)disclosure requirements. The liability has also increased for those who fail to comply. Lost in this shuffle is the fact that **fees are only one piece of the puzzle.**

It is often overlooked, but **a well drafted, reviewed and understood service agreement can help preclude errors and claims**. The service agreement is also **the primary defense against liability caused by service provider mistakes and negligence**. In spite of this important role, many plan sponsors - particularly small plan sponsors - sign standard service agreements without adequate review or counsel.

In addition to agreeing to vague service agreements, some sponsors engage advisors without a service agreement or verification of insurance coverage and bonding. As noted many times, most small plan sponsors also lack first party fiduciary liability insurance. A combination of the aforementioned is nothing less than a nuclear accident waiting to happen.

The DOL's new regulations provide an increase in both fee disclosure and clarity for comparative shopping, but 408(b)(2) does not preclude the need for an equitable service agreement. In our minds, **the service agreement remains a weak link in the advisor vetting process**, particularly in the small plan market. Indeed, the service agreement may not even reflect what was discussed and/or negotiated during the vetting process.

As noted by many attorneys, ERISA's primary focus has been on regulating the relationship between plan sponsors and participants. Beyond prohibited transactions and prior to the DOL's new disclosure regulations, little guidance was provided on how to manage the relationship between sponsors and service providers, including those assuming a fiduciary role.

The courts have not spoken uniformly about recourse between the plan and outside fiduciaries, but the plan sponsor's supervisory role, or the lack of it, has come under intense scrutiny in recent years. Because errors and disputes are a fact of life, **it is long past time for the service agreement to become an integral part of the advisor vetting process from the beginning.**

In short, **affirmative fiduciary coverage, applicable bonding and an equitable service agreement should be requirements to participate in the RFP process.** To save time, resources and limit liability, advisors lacking the aforementioned should be eliminated as soon as possible.

Setting The Stage

Before starting the service agreement review, sponsors should **determine if the service agreement presented by a dually registered rep is with the B-D's RIA or their independent firm.** If the advisor has the flexibility to use both agreements, the sponsor should understand the differences between them as well as what triggers the use of one over the other. Additionally, if a different service agreement is available to larger plans, sponsors should probe the threshold and note the differences between the agreements.

Like the pages and pages of seemingly inflexible *indemnification* and *arbitration* language, vendors will almost always lead with a standard service agreement that is skewed in their favor. As a result, it is important for both parties to **understand the liability associated with the services to be performed up front.**

The reciprocal **indemnification provisions are probably the most frequently negotiated component of the service agreement**, but small plans may lack the clout to obtain any revisions. The inability to get desired language included does not, however, preclude the plan sponsor from comparing the language to other service agreements and/or from shopping elsewhere.

To avoid problems, disputes and ensure that each party is liable for their own duties, the service agreement should **clarify the roles and responsibilities of the plan sponsor, the advisor and any other service provider.** The methodology for documenting communications should also be established.

In addition to providing a detailed explanation of the services provided and not provided, the agreement should address the vendor's fiduciary status. If the vendor is assuming a fiduciary role, the agreement should clearly state it. If the vendor is not assuming a fiduciary role, the contract should also state that.

To ensure it does not relieve the vendor of responsibility for their duties, the indemnification langue should be reviewed very carefully and contrasted with the DOL's somewhat limited 2002-08A Advisory Opinion. **The agreement should also include language that protects the plan sponsor from mistakes and breaches by the vendor.**

Reciprocal indemnification is important because **both parties should have recourse for liability caused by the other party without unreasonable caps, limits or a contractual "statute of limitations."** Given the potential for erosion of policy limits, plan sponsors and trustees should *not* rely on their policy to provide coverage when it is the advisor's liability that should respond.

The whole indemnification issue is a quagmire because **the existing regulations do not provide sufficient guidance to ensure sponsors have met their fiduciary duties.** Sponsors would violate their fiduciary duties if they agree to indemnification provisions without considering the reasonableness of the arrangement as a whole and the risks to participants. Sponsors must also determine whether they can obtain comparable services at comparable prices that provide greater protection to the plan.

The aforementioned fiduciary requirements sound reasonable, but they may not be practical or possible. To make matters more challenging, there is always the possibility that sponsors could be in violation of their fiduciary duties for simply agreeing to indemnification provisions. It should, however, be noted that **indemnification provisions that seek to relieve a service provider from the liability associated with any violation of their fiduciary duties would be void**, i.e., unenforceable.

In the event of errors, miscommunication, negligence or claims, **the dispute process should be stated clearly and reviewed carefully.** RIA contracts from B-Ds generally include mandatory arbitration while the contracts offered by consultants often include a dispute resolution process. While ERISA does not preclude a sponsor from accepting arbitration, attorneys often note that **ERISA preempts binding arbitration.**

Insurance and bonding requirements should be included in the service agreement. In addition to verifying affirmative fiduciary coverage and applicable bonding, **the sponsor should be named as a certificate holder** so they can be informed of lapsed coverage and other changes.

Not surprisingly, the service agreement should include a complete description of all direct and indirect fees, the form of compensation, who is responsible for paying the fees and how they will be paid. The vendor's ability to bill and or collect fees directly from the custodian is important because it is considered *discretion* and requires bonding. **Any other advisor access to plan assets should also be clearly spelled out and fully understood.**

In summary, **the service agreement should be reviewed carefully, constructed to ensure it accurately reflects the services to be provided and be subject to the full governance process.**

Suggested RFP Questions

The EAE Program's RFP questions are only available to paid sponsor clients. However, given the importance of the subject matter, we are listing some suggested questions below.

- Will our services agreement be with your BD's RIA or your independent firm? If you have the flexibility to use both agreements, describe the differences between them and what triggers the use of one over the other. Additionally, if you offer a different services agreement to larger plans, what is the threshold and how does it differ?
- Will you accept an ERISA fiduciary role in writing for the services requested? If so, what are your minimum requirements? Additionally, discuss the type of work and/or plans you will NOT accept ERISA fiduciary responsibility for.
- Does your services agreement list the services you will and will NOT provide to our plan along with your specific fiduciary duties?

- Does your service agreement state and provide details on services that you will provide to our plan that you are outsourcing?

- If requested, will you acknowledge in your services agreement that you are not allowed to market products or services beyond this engagement to any of our plan participants key employee or executives without our specific permission?

- Are the plan sponsor and advisor duties and responsibilities clearly defined in your services agreement?

- Does your agreement establish how communications will be documented? Please provide details.

- Does your service agreement include a complete description of your fees, the form of compensation, who is responsible for paying them and how they will be paid? Do you bill and/or collect fees directly from custodians?

- Does your service agreement acknowledge any discretion you have over plan assets, the ability to "handle" funds and any access to plan assets. If so, please provide the details.

- In the event of errors, miscommunication, negligence or claims, is the dispute resolution process clearly explained in your agreement. Is arbitration mandatory? Please provide details.

- Describe the indemnification clauses applicable to both parties, including limits, caps or time constraints?

- Specifically, what are you expecting the plan to indemnify you for and what are you indemnifying the plan for?

- Are the insurance and bonding requirements detailed in your agreement? Are you required to notify us of any changes in the requirements, carriers or coverage? To keep us informed of coverage and changes, will you name us as a certificate holder?

- What are the termination provisions of your contract, including any applicable penalties?

CHAPTER THIRTY
Fiduciary Training For Plan Sponsors

The responsibilities and consequences of becoming an ERISA fiduciary are a serious matter. Plan sponsors may or may not want to be fiduciaries, but given that fiduciary status is based on function, sponsors may not be given a choice.

Scandals, challenging investment markets and increased litigation have clearly heightened the scrutiny of plan sponsors in recent years. To mitigate risk and comply with their fiduciary responsibilities, **sponsors must understand the mandate imposed by ERISA**, including the exclusive benefit rule. Sponsors must also **demonstrate compliance with ERISA's fiduciary standards** by documenting their decision making process.

Because delegation can't relieve plan sponsors from all their fiduciary responsibilities and liability, a firm grasp of the applicable rules is imperative. While becoming a compliance expert could take years, sponsors can **gain the basic knowledge they need from fiduciary education programs.**

While most fiduciary training programs focus on investments, **monitoring outside consultants and participant communication is particularly important**. It is also essential for plan sponsors to **review all agreements with their service providers**, including advisors. As noted in chapter seventeen, **service agreements often attempt to relieve providers and advisors from liability** for their own mistakes, even when they fail to properly perform their job.

Plan sponsors are increasingly looking to their service providers and advisors for more help with fiduciary related requirements. While some feel this presents an opportunity, **advisors who provide training to plan sponsors, particularly on how to monitor service providers, walk a very fine line.** Indeed, numerous advisors with a singular business model are active in the fiduciary training area. As a result, it is unlikely that their approach to plan sponsor training would not emphasize their business model.

Acknowledging the need for fiduciary oversight, the DOL launched a nationwide campaign to educate plan sponsors about their fiduciary duties in the mid '70s. The DOL has also mandated fiduciary training as part of settlement agreements and they have been asking plan sponsors for proof of Fiduciary Committee training during recent audits.

The DOL's website provides basic materials on fiduciary duties, free seminar announcements and insight into what they view as common defects. The DOL's website also provides links to their existing programs and other publications. For more information on the DOL's fiduciary education program, go to: http://www.dol.gov/ebsa/fiduciaryeducation.html

Recognizing the increased complexity of compliance related regulations and the need for independent, unbiased and professional fiduciary training, the Profit Sharing/401k Council of America (PSCA) announced a new *Fiduciary Training Program* for plan sponsors in early 2011. The program was developed through a collaborative effort, including plan sponsors, fiduciary consultants and recognized ERISA attorneys.

Additionally, there are human resource type training programs available. Law firms also provide training services to their plan sponsor clients. Nevertheless, the new training program offered by the PSCA is an important development because much of the fiduciary training currently available is geared towards the trade or provided by the trade. For more information on the PSCA's new self-study, online ERISA Fiduciary Training Program, go to: https://www.fiduciary-education.org/index.php.

The International Foundation of Employee Benefit Plans (IFEBP) is another organization that offers fiduciary training in various modules of various courses applicable to their CEBS and RPA designations.

More applicable to plan trustees, the IFEBP also offers a standalone seventy minute online program called *Fiduciary Responsibility*. The low cost five lesson course includes: Fiduciary Responsibility, Fiduciary Duties, Delegation & Co-Fiduciaries, Prohibited Transactions and Bonding Requirements.

For more information on the five lesson Fiduciary Responsibility course, go to: https://webportal.ifebp.org/Purchase/ProductDetail.aspx?Product_code=dce37bc7-b5c0-dd11-9769-0050568c2813.

The EAE's new website will also provide fiduciary training resources for plan sponsors. Consistent with this guide and the EAE's online RFP service for advisor evaluation, the EAE's fiduciary training resources will emphasize the evaluation and monitoring of service providers.

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