NAGDCA

BEST PRACTICES GUIDE TO ADMINISTERING YOUR GOVERNMENTAL DEFINED CONTRIBUTION PLAN

PLAN GOVERNANCE

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PLAN GOVERNANCE

Defined contribution plans are a critical component to your employees' long-term financial future. As noted earlier, these plans are governed by specific sections of the Internal Revenue Code ("Code") and it is important for the plans to be both properly designed and administered in compliance with the Code, and other applicable requirements. This section addresses steps plan sponsors can take to ensure their plans operate smoothly and effectively.

I. Oversight Options

A number of key parties may be utilized to provide proper oversight and operation of your plan. In this section we'll review some of the most commonly used. Your plan may utilize some of them already; others may be resources you'll want to explore further.

Plan Board/ Committee – The most common form of plan governance involves creation of a specialized Board (or Committee) to assume oversight responsibilities of the defined contribution plans. While board size often varies (most frequently between five and nine members), the board's responsibilities are often quite similar. Key responsibilities can include:

- Facilitating and promoting the benefits of the plan among employees and emphasizing the importance of plan participation
- Designing the plan investment menu and monitoring the investment options
- Approving plan administrative and investment policies
- Approving changes to the services and features of the plans
- Establishing a communications and education plan
- Overseeing and monitoring the delivery of services to the plan in coordination with any established plan goals and objectives
- Procuring for plan services, and evaluating performance of any hired service providers or consultants
- Providing ongoing input on the plan services being delivered

Such Boards/Committees should meet on a regular basis (e.g., quarterly) to review the items as listed above and minutes should be documented as well. Frequently boards are made up of participants in the defined contribution plan from a diverse range of departments, backgrounds or employee groups. Recognizing that the financial expertise of some board members may be limited, some plans choose to fill a portion of the voting member positions with private sector representatives with investment or financial service backgrounds who can provide supporting expertise. Some boards may also include representatives of the retired participant community.

Outside Expertise – The level of expertise of the board often varies and it can be in the best interest of board members and the plan sponsor to hire outside experts to assist board

members in effectively executing their responsibilities. *Plan consultants* may be hired to provide best practice or industry guidance with respect to education and plan administration, or fund line-up design and review. A more specialized *investment advisor* may assume primary responsibility for developing recommendations for investment menu design, oversight and reporting of investment performance, and recommendations of fund line-up changes, among other responsibilities. The plan will usually bear the costs of these additional professional services.

Supporting Authorities – *Legal support* is often critical to the successful oversight of a plan and the support may come from internal counsel, a hired external counsel, or both. Internal legal counsel may not have the level of expertise needed to comfortably guide a Board through a potential maze of issues relating to plan administration, so a Board may choose to hire outside expertise at the plan's expense. Legal support is there to ensure decisions are made in compliance with applicable Federal/State laws and regulations, employer procurement rules, and, at all times, in the best interest of plan participants.

Sub-Committees may also be established on a regular or periodic basis to address more specialized areas of particular importance to the plan. An Investment or an Education Sub-Committee are both examples of smaller, specialized teams that focus on key targeted areas and are expected to report back to the entire board. Most frequently, sub-committees may make recommendations to the entire board but have not been delegated exclusive decision-making authority.

The entity's governing *legislature*, *Council*, *Board of Supervisors* or *other governmental authority* often plays a critical role in the administration of the plan. While not as frequently participating directly on a plan board, these entities often play a decisive role in key decisions related to the plan. Most specifically, they may make key decisions regarding establishing the plan, determining how the plan will be governed, and approving contracts. If this is the case in your plan, it is often a good idea to keep that entity well informed of any issues on which they may ultimately be asked to rule or which would be of interest to them in their specific oversight capacity.

Possible Alternatives for Smaller Plans – Not all plans are of a size where they can afford the kind of legal and external support resources described above, but the proper governance of these employers' plans is no less critical. Although a plan board/committee approach is preferred, some smaller plan sponsors may choose to assign the responsibilities to a designated Administrator within the employer, and the Administrator is then granted the authority to make key decisions for the plan. If there is more than one individual designated, language should be clear around where the various responsibilities and authori-

ties lie. Due to their lack of internal resources, Administrators in this role often rely more greatly on the experience of and the information and guidance provided by the plan record keeper. Administrators in this situation should nevertheless provide ongoing scrutiny of all service providers to ensure the proper execution of their oversight role. Further, assigning such duties to an administrator does not relieve the government and the primary officers of their fiduciary responsibilities.

II. Fiduciary Responsibility

The term "fiduciary" might seem confusing or intimidating to a board member, a plan administrator or individuals responsible for overseeing the plan. Many individuals want more information about what the responsibility means and whether and how it applies to them in their respective roles. Although fiduciary actions are important and carry a high level of responsibility, there are a number of best practices and safeguards which help ensure that a fiduciary makes informed decisions in the best interests of plan participants and is protected against liability.

How Do We Assume Fiduciary Responsibility? – Individuals/entities are considered to be acting in a fiduciary capacity if they 1) exercise discretion with respect to the management of the plan or its assets, 2) have discretionary authority or responsibility in the administration of the plan, or 3) provide investment advice for compensation. When performed in the framework of plan procedures and guidelines, other responsibilities such as keeping participant records, providing education and educational materials, or processing contributions and withdrawals are non-fiduciary activities. It is important for all fiduciaries to be aware of and understand when they are serving in that role. A fiduciary's efforts to disclaim responsibility are rarely successful if they actually exercise the authority that gives rise to fiduciary status. The Department of Labor (DOL) has indicated that some roles, such as plan sponsor or trustee, by their very nature assume fiduciary status.

Fiduciary Responsibilities – Fiduciaries have important responsibilities and are subject to standards of conduct because they act on behalf of participants in a retirement plan. Fiduciaries must act solely in the interest of plan participants and their beneficiaries. They are expected to carry out their responsibilities prudently, ensure the plan operates in compliance with the plan document, diversify the plan investments, and seek to ensure that participants are paying reasonable fees.

But plan sponsors may be pleased to know that fiduciary status is not an "all or nothing" concept. For example, where a plan sponsor engages a third party to provide administrative or investment related services for plan participants, the employer's main fiduciary responsibility is to exercise care and prudence in selecting and monitoring plan investments, monitoring the provider's performance, and reviewing the continued appropriateness to provide services for the plan, given the plan's overall objectives and guidelines.

Committee members and key plan staff should consider receiving some level of fiduciary training to better understand their responsibilities. Your plan's record keeper or consultant

can be a good resource. Also, the NAGDCA website (www.NAGDCA.org) has a Fiduciary Education Resource Center with links to additional information regarding fiduciary responsibilities. It is also a good idea to check to see if there are any particular state laws regarding fiduciary duties.

Fiduciary Protection – Acting prudently is a primary fiduciary responsibility, and it can require expertise in a variety of areas. Lacking that expertise, a fiduciary may want to hire someone with the professional knowledge to carry out the function, such as, for example, an investment consultant. An important focus of fiduciary decision-making is *process*, and documenting the basis for decisions. For instance, when hiring other entities to provide support, a fiduciary would ideally survey a number of potential providers, make a meaningful side-by-side comparison, and document the basis for the selection. In monitoring service providers, an employer should establish and follow a review process at reasonable intervals to ensure they are meeting their contractual obligations and the needs of the plan sponsor and its employees.

Public sector plans are technically exempt from ERISA requirements. But many states have similar fiduciary requirements and it's wise to use ERISA as a guideline for addressing one's fiduciary responsibilities. ERISA Section 404(c) provides "safe harbor" relief from fiduciary liability in the event of losses in plans where participants exercise control over their own account assets. In order for plan fiduciaries to avail themselves of this protection, participants must be provided with a broad range of investment options and the ability to exercise investment control, including the ability to make investment changes at least quarterly. To the extent these requirements are met, plan sponsors likely would be relieved from liability with respect to participant losses in accounts that participants direct for themselves.

III. Plan Documents

A written plan document, in essence a blueprint defining the offerings and the general operational procedures that will govern your plan, is required under the Internal Revenue Code. One essential plan document, or separate trust document, provision must specify that plan assets will at all times be held in trust for the exclusive benefit of plan participants. As a plan sponsor you must maintain the administration of the plan in compliance with this document, and failure to do so could jeopardize the plan's tax status and the rights of plan participants.

IRS Approval – Obtaining IRS approval of your plan document can provide a level of comfort that your plan is operating in compliance with the Code. There are two major protocols for designing a plan document and securing IRS approval. In an *individually-designed plan*, the employer can write its own plan document and submit it to the IRS for a private letter ruling (457 plan), or a determination letter (401 plan). A second approach is a *volume submitter letter*, where one plan document, often written by a plan service provider, is submitted to the IRS for an advisory opinion letter. Other employers who use that model plan document and do not deviate from the provisions as they are written, can operate their plan with reliance on that plan's advisory opinion letter, despite not seeking their own individual IRS approval.

BEST PRACTICE ALERT – Producing good written minutes of your meetings is one of the most valuable tools you can use to document the fulfillment of your fiduciary role and provide a reliable record of how and why changes were made. Finding the right level of detail to include in minutes can sometimes be challenging. Some organizations tend to record only voting and final actions, while others may try to include every thought that was expressed by everyone present. The best practice is usually found at a point between these two extremes.

Minutes should ideally capture not just final outcomes but the most essential components of the deliberative process. This is particularly valuable with issues which may involve some controversy or challenging judgment calls. By demonstrating that your deliberations approached the issue prudently and in good faith, your organization will be well supported in the event the decision is questioned by a participant or some external individual or entity. Detailed minutes provide valuable information to future administrators and staff as they look back and try to determine why their predecessors made certain decisions. They also provide the same benefit to plan participants.

level of both internal and external guidance resources they have available.

Plan Document Maintenance – It is also a responsibility to make sure the plan document remains up-to-date with current Code, Treasury regulation requirements and plan provisions. Over the years, it is quite normal to see changes in the Code and Treasury regulations, or the addition of provisions that are analogous with ERISA guidelines. Your state may also implement statutory or regulatory changes that impact your plan. Depending on the approach you have selected for designing your plan document, your plan provider may assume this responsibility. But either way, it is reasonable to expect that, at a minimum of every five years, the plan document will require some degree of updating, and you want to ensure there is a process in place to accomplish this.

Plan Record Retention – It's a good idea for plan sponsors to retain indefinitely a number of critical documents that demonstrate the effective management and administration of the plan. A copy of every version of the plan document, including amendments and adoption agreements, should be kept for at least six years after the termination of the plan. Signed contracts with service providers, including any updates or amendments that may have taken place over time, should be readily available, along with any communications to plan participants regarding plan changes or amendments. Evidence of the selection process of Committee members that was used, including filling vacant spots on the committee, should be retained, along with meeting notes. It is also a good idea to retain evidence of steps taken to review and monitor plan services delivered, including the educational outreach efforts to plan participants, their outcomes, and the performance of the investment line-up. This may be accomplished

each year through the careful review of a detailed Annual Plan Review, or similar document, from your plan record keeper, which may store much of this information in a single document.

You should also check whether state or local laws identify specific time periods for retaining plan records.

Participant Record Retention, including Beneficiary Data – While the Department of Labor (DOL) does not have specific requirements regarding the retention of participant records, in particular participant beneficiary records, a common practice is to retain all participant records at least until the account has been totally depleted, either through extended benefit payments or transfer to another plan or IRA. Even then, industry practice is often to retain beneficiary records, in particular, for an unlimited period of time. As with other plan administration functions, the plan sponsor may delegate record retention to the plan record keeper.

In an increasingly electronic world, there may be no paper trail of a beneficiary designation. If so, the plan may rely heavily on electronic communications and confirmations to plan participants. Therefore, the Plan Document should provide clear guidance on the designation of a default beneficiary, in the event participants fail to make a selection upon enrollment. And to ensure participants are aware of the beneficiary designation they have on record, steps such as posting current beneficiaries on participant statements and providing participants with written confirmations of all beneficiary record changes, help to ensure that participant records remain up-to-date and accurate.

You should also check whether state or local laws identify specific time periods for retaining certain types of participant records.

IV. Optional Documents

While a current and operable plan document is a tax code requirement, there are a number of additional, optional supporting documents for you to consider that may help ensure the smooth operation of your plan.

By-Laws or Charter Documents – These documents are meant to clearly outline items involved in the governance of your plan, such as the individuals or body that is responsible for carrying out plan duties. Members are best identified by job function rather than individually, since the faces will change over time. If there is a governing board, the by-laws may outline the composition of the board, its size, the length of terms served, the frequency of board meetings, any qualifications or expertise that is required, the process for selecting members, and potential attendance requirements. The by-laws should address any issues the plan sponsor considers critical to the successful operation and oversight of the plan, and steps that will be taken to ensure ongoing compliance.

Policy Manual – This document is an operational guide on how to and who is responsible for carrying out the various administrative responsibilities to keep your plan running smoothly.

Roles and responsibilities are clearly defined and, where appropriate, it can reference the responsibilities that are being delegated to the plan provider or record keeper.

Investment Policy Statement – Fiduciaries are required to diversify plan investments to minimize the risk of sustained loss. Selecting and monitoring investment options is a fiduciary responsibility and a process that employers will want to document. The basic guidelines for reviewing investments are often incorporated in a plan's Investment Policy Statement (IPS) in varying levels of detail. The IPS should more clearly define the types of investments considered appropriate for your plan, and the standards for reviewing and evaluating funds, their performance, and the guidelines by which changes would be made.

The IPS should provide enough latitude to perform in-depth analysis of the investment options, but also avoid excessively stringent performance guidelines on plan investments and their addition, change, or removal. The statement may also identify whether a separate investment consultant would be hired, and, if so, the level of oversight and discretion that will be granted to the consultant.

In summary, for the successful governance of your defined contribution plan, it is essential for plan fiduciaries to both understand the important responsibilities they assume and the critical nature of their role to act solely in the best interest of the plan's participants and beneficiaries. A thoughtful and well-organized plan will help to ensure smooth operation, and there are a number of professional resources available to support plan sponsors in this endeavor. Most important, a thorough, well-documented process can help to provide the proper level of protection that fiduciaries seek.

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