

Selecting & Monitoring 401(k) Plan Providers Under ERISA: THE INVESTMENT DUE DILIGENCE PROCESS

A WHITE PAPER

by

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I. Executive Summary

The 401(k) market sometimes ignores the central social and legal purpose of these plans: to provide *retirement benefits* to employees. Sponsoring a plan is not primarily about providing investments, even sound investments (though that is certainly important); instead it is about the adequacy and quality of benefits that participating employees are accumulating for retirement. Fiduciaries in participant-directed 401(k) plans are responsible for managing that process in a careful, skillful, knowledgeable and prudent manner.¹ (We use the term “fiduciary” throughout this White Paper; in doing so, we are referring to the corporate officers and/or committee members who make decisions about the investment and administration of ERISA-governed retirement plans – and particularly 401(k) plans. Because of that discretion and control, ERISA labels those people as fiduciaries and imposes significant legal responsibilities on them.)

Under the Employee Retirement Income Security Act of 1974 (“ERISA”), fiduciaries must act solely in the interests of participants (the duty of loyalty) and for the exclusive purpose of providing retirement benefits (the exclusive purpose rule).² Every action fiduciaries take, every decision they make, must be consistent with that purpose. The conduct of fiduciaries in fulfilling this objective is measured under the prudent man standard (sometimes called the “prudent expert rule”),³ which requires that fiduciaries make informed and reasoned decisions.

In more concrete terms, this means that fiduciaries have a legal obligation to act prudently in selecting plan providers, investments and participant services. And, once selected, they have a duty to monitor the performance of the investments and providers on an ongoing basis. How do fiduciaries fulfill this obligation? They must be aware of the legally defined purpose of 401(k) plans and of the decisions they need to make; determine the information that is relevant to analyzing and making those decisions; gather the relevant information; analyze it in light of the needs of the participants; and make a decision in the participants’ best interests. In short, the fiduciaries must engage in a prudent process – to look at the right information in the right way.⁴

The steps in this process are orderly and logical. Nevertheless, they do require a level of expertise – expertise in selecting investments and services that will produce meaningful retirement benefits in the context of a participant-directed plan, taking into account the unique needs of the employees covered by the plan. Thus, the key to the prudent process is deciding on and gathering the information that a prudent and knowledgeable fiduciary would determine is needed in order to make an informed and reasoned decision.

In our experience, many fiduciaries lack the expertise or access to the information needed to satisfy the prudent process requirement. In that case, the fiduciaries should look to knowledgeable third parties to assist them. Indeed, ERISA sometimes requires that fiduciaries hire experts to help conduct the appropriate investigation and properly analyze the data. While fiduciaries may rely on such experts for assistance, they cannot blindly rely on their help; instead, the fiduciaries must understand the advice they are receiving,

evaluate the merits of that advice and make the final decision to select a provider, the investments and the needed participant services.

401(k) Advisors specializes in assisting 401(k) fiduciaries with their responsibilities under ERISA. Materials provided to us by 401(k) Advisors regarding its practices describe an investment due diligence process designed to produce a thorough and rigorous analysis of providers and investments, at both the initial search phase and the monitoring phase, and a means of delivering the information to fiduciaries that is consistent, relevant and specific. These steps are intended to help fiduciaries engage in a prudent process and make appropriate decisions for the benefit of their participants. In short, it is intended to help the fiduciaries meet their obligations under ERISA.

In the following sections of this White Paper, we first discuss ERISA fiduciary requirements in terms of the basic duties, including the duty to conduct a thorough investigation of relevant information, the requirement that the fiduciaries apply generally accepted investment theories and prevailing investment industry practices in selecting investments, and the duty to monitor the investments and services selected by the fiduciaries. We then summarize these duties in a section on the prudent fiduciary process. Next, we address how a fiduciary, who lacks the information and possibly the expert knowledge to fulfill these duties, should engage the assistance of experts and what the requirements are for relying on expert assistance and advice. Finally, we described the 401(k) Advisors services and how these services will help fiduciaries fulfill their duties.

Based on our review of the 401(k) Advisors process and our experience in working with plan fiduciaries, providers and advisers, we believe that the services offered by 401(k) Advisors provide significant help to fiduciaries in fulfilling their obligations under ERISA.

II. ERISA Fiduciary Duties

A. *The Basic Duty*

The duties of fiduciaries under ERISA are set out in Section 404(a)(1). That section requires that fiduciaries fulfill the following requirements:

“...a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and –
(A) for the exclusive purpose of:
(i) providing benefits to participants and their beneficiaries; and
(ii) defraying the reasonable expenses of administering the plan;
(B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims....”

The most important key requirement (at least in our opinion) is contained in subsection (A), the “exclusive purpose” rule: fiduciaries must always act in a manner consistent with providing retirement benefits for the participants. The standard used in measuring the conduct of the fiduciaries in doing that job is found in subsection (B), the prudent man requirement. The requirement that fiduciaries be “familiar with such matters” has led to this being referred to as the “prudent expert rule” because of the stated requirement that the fiduciaries have the level of expertise of a knowledgeable investor. (For example, a fiduciary should understand the concepts of Modern Portfolio Theory in order to properly select investments that allow participants to prudently balance risk and reward.) That standard also requires, among other things, that the fiduciaries understand “the circumstances then prevailing” (for example, the features and services available to plans) and that they be “familiar with such matters,” *i.e.*, operating and selecting investments for a participant-directed retirement plan.

Stated in more practical terms, 404(a)(1) requires that fiduciaries understand and consider:

- The objective of the plan to provide retirement benefits;
- The participant investment abilities and thus their needs for investment services;
- The investments and participant services available in the marketplace;
- The range of costs of these investments and services; and

- The practices of knowledgeable fiduciaries in selecting the investments and services for others to use for accumulating retirement savings.

In discussing the investment duties of fiduciaries, the Department of Labor (DOL) has explained the prudent man requirement. In Regulations under Section 404(a), the DOL states:

“With regard to an investment or investment course of action taken by a fiduciary of an employee benefit plan pursuant to his investment duties, the requirements of section 404(a)(1)(B) of the Act...are satisfied if the fiduciary (A) has given **appropriate consideration to those facts and circumstances** that...the fiduciary **knows or should know are relevant** to the particular investment or investment course of action involved, including the role the investment or investment course of action plays in that portion of the plan’s investment portfolio with respect to which the fiduciary has investment duties; and (B) has acted accordingly.”⁵
[Emphasis added]

As the highlighted language of this Regulation indicates, there are several factors that apply to decisions surrounding plan investments:

1. The fiduciaries must determine which “facts and circumstances” they need in order to make a proper decision, for example, for the selection and monitoring of investments or a plan provider, and then must gather information about those facts and circumstances.
2. The fiduciaries must take into account information that is “relevant” to making an informed decision. And this information must include not only what the fiduciary “knows” is significant to the decision, but also what he “should know” is relevant. The “should know” requirement implies an obligation to investigate (or to hire an expert) in order to understand the questions to be decided and to determine the information that is relevant to the decision-making process.
3. The fiduciaries must then “give appropriate consideration” to the relevant information. That is, they must review and evaluate the relevant information as a basis for making a decision that is both informed and reasoned.⁶ By this we mean that the decision must be “informed” by the fiduciaries’ review of the relevant information and must be “reasoned” in the sense that it has a reasonable connection to that information.

B. *The Duty to Investigate*

The requirement to act prudently in selecting and monitoring investments and services has two parts: the *conduct* required of the fiduciaries and the *results* they are expected to achieve. In evaluating fiduciary conduct, the courts look at “procedural prudence” – that is, the process used in making decisions. Of course, the courts also look at the quality of the fiduciaries’ decisions. As one court said:

“To enforce [ERISA’s fiduciary duties], the court focuses not only on the merits of the transaction, but also on the thoroughness of the investigation into the merits of the transaction.”⁷

And another court explained:

“It is by now black-letter ERISA law that ‘the most basic of ERISA’s investment fiduciary duties [is] the duty to conduct an *independent investigation* into the merits of a particular investment.’ *In Re Unisys Savings Plan Litig.*, 74 F.3d 420, 435 (3rd Cir 1996).”⁸ [Emphasis added]

The dual obligations under the prudence requirement were perhaps best described in an opinion written by then Circuit Judge, now Supreme Court Justice, Antonin Scalia: “in short,” he said, “there are two related but distinct duties imposed upon a trustee: to investigate and evaluate investments, and to invest prudently.”⁹ Stated another way, the requirements consists of “*procedural prudence*,” which is the *process* of investigating, deliberating and deciding, and “*substantive prudence*,” or the duty to review the “substance,” the right information, and to make a reasoned decision – that is, a decision reasonably based on the relevant facts. A proper investigation enables the fiduciaries to make prudent investment decisions.

The DOL has not issued formal guidance concerning the search for a provider of services and investments for participant-directed 401(k) plans. However, in commenting on the process to be used in selecting a provider from which to purchase annuities for a pension plan, the DOL said that:

“...plan fiduciaries [must] conduct an objective, thorough and analytical search.... In conducting such a search, a fiduciary must evaluate a number of factors [and] reliance solely on ratings provided by insurance rating services would not be sufficient to meet this requirement.”¹⁰

This Regulation highlights that fiduciaries must conduct a thorough investigation and a rigorous consideration of the relevant information

before selecting a provider for the plan. By analogy, it would not be sufficient for a fiduciary to simply rely on ratings by a mutual fund rating service. Instead, fiduciaries must consider both the quantitative and qualitative factor appropriate for best deciding whether a mutual fund will likely fulfill its role in the future. After all, 401(k) investments are selected and monitored for the purpose of future investing, not past performance.

It is sometimes argued that the duties we are describing – to engage in procedural prudence and substantive prudence – apply only to large plans, since (the argument goes) small to mid-sized plans do not have the access to information or the fiduciary expertise available to them to meet these requirements. This is a fallacy.

When the DOL first proposed its regulation under ERISA Section 404(a)(1) (quoted earlier) that requires fiduciaries to give appropriate consideration to all relevant factors in making investment choices, some commentators suggested that the regulation could “be read as establishing an impossible standard, especially for fiduciaries of small plans.” In response, the DOL said that it would not “distinguish among classes of fiduciaries...”¹¹

We next discuss the requirement to use generally accepted investment theories in the procedural prudence process of selecting investments.

C. *Generally Accepted Investment Theories*

In making their investment decisions, fiduciaries must consider generally accepted investment theories, including the modern portfolio theory, and prevailing investment industry practices. By “generally accepted investment theories,” we are referring to the fundamental principles underlying modern concepts of proper investing. These include the modern portfolio theory and strategic asset allocation – looking at an investment portfolio as a whole and taking into account diversification within the portfolio. “Prevailing industry practices” refers to the techniques that investment managers and advisors use in applying generally accepted investment theories, such as the quantitative and qualitative measures that are used to judge the quality and expected future performance of various investments. This refers to the information that is gathered and analyzed to determine how well the various parts of a portfolio are meeting the overall objective for the portfolio.

In a leading case, the court characterized the fiduciary investment duty under ERISA as follows:

“In general, the regulations [under ERISA Section 404(a)(1) quoted earlier] provide that the fiduciary shall be required to act as a prudent investment manager under *the modern portfolio theory*

rather than under the common law of trusts standard....”¹²
[Emphasis added]

In its regulations, the DOL also makes reference to generally accepted investment theories.¹³

The courts have further validated this requirement by finding that fiduciaries breached their duties when they failed to observe prevailing industry standards. In one case, the court described the fiduciary requirement as follows:

“Rather, the prudent person standard has been determined by the courts to be an objective standard, requiring the fiduciary to (1) employ proper methods to investigate, evaluate and structure the investment; (2) act in a manner as would others who have a capacity and familiarity with such matters; and (3) exercise independent judgment when making investment decisions. [citations omitted] This standard requires that *the fiduciary's behavior be measured as against the standards in the investment industry. Jones v. O'Higgins*, No. 87-CV-1002, slip op. at 19, 1989 WL 103035.”¹⁴ [Emphasis added]

If fiduciaries do not have a grasp of these theories and principles, it will be difficult, if not impossible, for them to prudently select and monitor the investments to be offered for participant direction. For example, for participant-directed plans, fiduciaries must select a variety of investment categories (or “asset classes,” as they are called by investment specialists). The number and types of investment must be adequate to allow participants to use those investments to properly balance risk-and-reward according to their needs. Many experts believe that at least six or seven specific types of investments are needed for that purpose. Regardless of the exact number or type, though, this illustrates that fiduciaries need to understand these concepts to prudently fulfill their responsibilities.

We now turn to the on-going duty of fiduciaries who have engaged in a prudent process of selecting investments and service providers to periodically review those decisions.

D. *The Duty to Monitor*

The job of the fiduciaries is not complete when they have made an initial prudent decision. They still have an on-going duty to periodically review the investments and services offered by the plan and to decide whether their initial decisions remain valid in light of changed circumstances. Under ERISA, this is called the “duty to monitor,” to which should be

added “the duty to remove and replace” those providers or investments that are no longer prudent and suitable for the plan.

In describing the obligations of fiduciaries, the courts have said that “ERISA fiduciaries must monitor investments with reasonable diligence and dispose of investments which are improper to keep.”¹⁵ And again: “Once an investment has been made, a fiduciary has an ongoing duty to monitor investments with reasonable diligence and remove plan assets from an investment that is improper.”¹⁶

The duty to monitor applies to more than just the investments. The fiduciaries have an obligation to monitor, remove and replace both fiduciaries and service providers, including other fiduciaries. For example, if a Board of Directors appoints a plan committee, the Board members are collectively and individually fiduciaries for that purpose.¹⁷ As such, they have a duty to monitor the committee and to remove committee members who are not doing their jobs. The DOL explained this requirement in Interpretive Bulletin 96-1 as it applies to the providers of investment education and investment advice:

*“As with any designation of a service provider to a plan, the designation of a person(s) to provide investment education services or investment advice to plan participants and beneficiaries is an exercise of discretionary authority or control with respect to management of the plan; therefore, persons making the designation must act prudently and solely in the interests of the plan participants and beneficiaries, both in making the designation(s) and in continuing such designations(s).”*¹⁸ [Emphasis added]

In monitoring the provider of investment education (typically the recordkeeper or investment provider), the fiduciaries must consider both the quality of the services and the effectiveness of the services (for example, is the education working . . . are the participants investing better?). Even if fiduciaries lack the ability to evaluate and answer the questions, they are still responsible for that job. In that case, the fiduciaries would be well-advised to use the services of a knowledgeable and experience advisors.

So, it is not enough for fiduciaries to act prudently and in the best interests of the participants when they *select* providers or investments. They must periodically review their decisions, gather more relevant information and go through a process of monitoring the performance of the selected provider to determine whether to reaffirm or change their original decision.

E. The Fiduciary Process

There are five steps in a prudent process for selecting and monitoring the investments and related services for participant-directed plans:

1. The fiduciaries must understand the needs of the employee workforce, for example, their level of sophistication in investing and their willingness to undertake the task of managing their own accounts. Based on that analysis, the fiduciaries must select a suitable investment structure. In this context, “investment structure” refers to fundamental, or structural investment questions, such as whether to offer, in addition to the core mutual funds, non-core investment options, stock brokerage windows, managed accounts, risk-based lifestyle funds and age-based lifecycle funds, and the like.
2. The fiduciaries must then select the asset classes (or investment categories) for which investments will be made available to the participants. As noted earlier, the selection of these asset classes must be based on generally accepted investment theories, such as the modern portfolio theory. (By way of example, commonly used assets classes include U.S. large capitalization growth and value equities, U.S. small capitalization growth and value equities, international developed market equities, U.S. intermediate term or multi-sector bonds, and stable value.)
3. The fiduciaries must prudently select (at the level of a knowledgeable investor) the individual fund or funds to be offered in each of those classes, taking into account relevant quantitative and qualitative information about the investments and the investment managers.
4. The fiduciaries must select a provider (which for these purposes may be a “bundled” provider that handles all of the plan’s needs or several different service providers who, in combination, handle those needs, often through an alliance arrangement) that will, at a reasonable cost, provide the investments and services necessary for the operation of the plan. Steps 3 and 4 will generally be done in tandem, since it is often not possible to select the investments without having selected the investment provider. For these purposes, “reasonable cost” refers to costs that are appropriate for the types and quality of the services that the plan and participants are receiving from the provider.
5. The fiduciaries must monitor the foregoing for on-going appropriateness and effectiveness. By “effectiveness,” we are referring to both the quality of the investments and to whether the

investments and services are actually producing adequate retirement benefits (for example, a high level of participation, adequate levels of deferrals, and prudent investing by participants).

How does a fiduciary complete these steps in the fiduciary process, especially if they lack the necessary knowledge, information or experience? This is discussed in the next section.

III. Reliance on Experts

Not everyone who becomes a fiduciary is an expert in running a retirement plan or selecting investments. ERISA recognizes this fact and permits fiduciaries (indeed, sometimes requires them) to rely on third parties, both experts that are fiduciaries and providers that are not fiduciaries, in fulfilling their duties.¹⁹

A. *Selection of an Expert*

The DOL has stated that fiduciaries must seek help if they are not able to fulfill their duties themselves. In one regulation, the DOL said: “Unless they possess the necessary expertise to evaluate such factors, fiduciaries would need to obtain the advice of a qualified, independent expert.”²⁰ Soon after ERISA was enacted, the DOL discussed whether a fiduciary could properly discharge its duties if it relied on others to provide them with information. In approving this practice, the DOL stated:

“A plan fiduciary may rely on information, data, statistics or analyses furnished by persons performing ministerial functions for the plan, provided that he has exercised prudence in the selection and retention of such persons. The plan fiduciary will be deemed to have acted prudently in such selection and retention *if, in the exercise of ordinary care in such situation, he has no reason to doubt the competence, integrity or responsibility of such persons.*”²¹ [Emphasis added]

The courts have adopted the same view, one court explaining that “Fiduciaries need not become experts in employee benefits, and may rely on independent expert advice...”²²

In fact, the courts recognize that reliance on an expert may actually be required in order for fiduciaries to fulfill their duties. As one court said, “A fiduciary’s effort to obtain an independent assessment serves as evidence that the fiduciary undertook a thorough investigation....” And another court described the duty as follows:

“where the trustees lack the requisite knowledge, experience and expertise to make the necessary decisions with respect to investments, their fiduciary obligations require them to hire independent professional advisors.”²³

In a case where it was alleged that fiduciaries had breached their duties, the court said:

“Although reliance on an adviser will not immunize a trustee’s [or other fiduciary’s] actions, it is a factor to be weighed in determining whether a trustee breached his or her duty.”²⁴

As can be seen from the statements quoted in this section, a critical thread running through all of these observations is the requirement that the advisor be independent. As stated in one case, “One extremely important factor is whether the expert advisor truly offers independent and impartial advice.”²⁵

In some cases, the fiduciaries may be *required* to engage experts to assist them. For example, in one case, the court said:

“While a trustee has a duty to seek independent advice where he lacks the requisite education, experience and skill [citation omitted], the trustee nevertheless must make his own decision based on that advice.”²⁶

But to what extent may a fiduciary rely on expert advice? This is discussed in the following section.

B. Extent of Reliance

The courts make it clear that the fiduciaries have an obligation to continue to exercise judgment and may only rely on an expert that is qualified. Indeed, the fiduciaries must still reasonably review, understand and approve the advice²⁷:

“Fiduciaries...are entitled to rely on the advice they obtain from independent experts. *Those fiduciaries may not, however, rely blindly on that advice.* In order to rely on an expert’s advice, a ‘fiduciary must (1) investigate the expert’s qualifications, (2) provide the expert with complete and accurate information, and (3) make certain that reliance on the expert’s advice is reasonably justified under the circumstances.’”²⁸ [Emphasis added]

And in another case, the court found that a fiduciary

“is not justified . . . in relying wholly upon the advice of others, since it is his duty to exercise his own judgment in light of the information and advice which he receives.”²⁹

At the same time, fiduciaries are not required to have the same level of expertise as their consultants or to duplicate their work. As one court said,

“we would encourage fiduciaries to retain the services of consultants when they need outside assistance to make prudent investments and do not expect fiduciaries to duplicate their advisers’ investigative efforts. . . .”³⁰

Thus, the duty of fiduciaries is to engage outside help when they need it, to ask questions about the advice they receive to ensure they understand it and only then to take action in reliance on that advice. Nevertheless, the fiduciaries do not need to become experts themselves in order to fulfill their duties.

We have previously described the most important investment duties of 401(k) fiduciaries: to act for the exclusive purpose of providing retirement benefits for their participants; to pay only reasonable expenses; to know the needs of the plan and its participants;³¹ to conduct a thorough investigation regarding the products and services in the market place as well as those currently offered in their own plan; and to analyze those products and services as compared to the plan's needs. While the fiduciaries may rely on experts to assist them in fulfilling these duties, as explained earlier, they must determine that the expert is qualified and that they evaluate, understand and approve the expert's advice. The following section describes a service that will assist fiduciaries in fulfilling their obligations under ERISA.

IV. 401(k) Advisors Investment Due Diligence Process

A. Description of the Service

We have reviewed materials provided to us by 401(k) Advisors that describe the firm's processes and services. The following discussion is based on our review of those materials.

401(k) Advisors has developed processes and services designed to help plan fiduciaries satisfy their investment responsibilities under ERISA. Its mission is to create a successful retirement plan for both employers and employees by helping fiduciaries save time, reduce exposure to fiduciary liability, address IRS and DOL compliance requirements and maximize the potential investment return opportunities for participants. Its client service process consists of the following steps:

- Discuss the client's perceptions of the plan's existing provider to determine whether a vendor search is warranted;
- If the answer is yes, conduct a vendor search, including a thorough vendor review that consists of preparation of and review of requests for proposal, attending vendor presentations; evaluating and preparing spreadsheets of the information presented and preparing a detailed report with a recommendation of the most appropriate provider;
- Help facilitate the conversion process from the old to the new vendor;
- Complete a detailed plan design and investment review, including a detailed fund analysis and recommendations;
- Implement the plan design, investment recommendations, participant education and compliance processes as a result of the review;
- Conduct on-site enrollment and participant education meetings;
- Monitor plan compliance and investments and provide on-going fiduciary and participant education, plan sponsor consultation and guidance.

Its investment due diligence process is equally detailed and designed both to assist the fiduciaries in fulfilling their ERISA duties and in increasing the investment opportunities for employees. Among the steps it takes are helping to set investment goals and objectives for the plan; providing an investment policy template for the fiduciaries; reviewing investment providers and making recommendations regarding whether to select a new provider or remain with the existing one; conducting a comprehensive investment analysis (described below); identify funds for each asset class and recommend funds based on the criteria identified in the plan's investment policy statement; and monitor the funds. A major component of its analysis is identification of the appropriate asset classes and the

appropriate percentages of each – in other words, designing the plan’s investment portfolio using modern portfolio theory.

The fund analysis included in the due diligence process looks at quantitative and qualitative factors making use of the *Zephyr Style Advisor*, one of the three main “industry-standard” quantitative research programs. In this way, 401(k) Advisors adheres to prevailing industry standards in performing its services. The information is provided to the client in a detailed report that includes a proprietary system called the *Scorecard* system that allows fiduciaries to compare and contrast the strengths and weaknesses of each fund, using a numerical system. The scores are contained in a chart that is explained in detail in other parts of the report, but presents the results of the analysis in a short-hand way for ease of comparison of various funds in each asset class. A score of 9-10 is good, 7-8 is acceptable, 5-6 requires the fund to be put on the watch list and 0-4 means that the fund should be removed and replaced.

Eighty percent of a fund’s score is quantitative, using the following factors:

- style analysis (which determines the style of a fund over a period of time)
- rolling style analysis (that is, a returns based analysis over multiple time periods to determine the behavior of the fund/manager)
- risk/return compared to the appropriate benchmark
- r-squared (which measures the percentage of a fund’s return that is attributable to general market performance)
- up/down capture (which measures the behavior of the fund in up and down markets)
- information ratio (which measures a fund’s relative risk and return), peer group ranking (a fund passes if it is above the 50th percentile)
- information ratio peer group ranking (a fund passes if its median rank is above the 50th percentile).

The remaining 20% of the score is qualitative, taking into account manager tenure and the fund’s expense ration relative to other funds options in the asset class, the strength or weakness of the fund’s statistics, the health of the firm (taking into account factors such as changes in ownership or managers of the fund or changes in the manager’s business plan) and changes in the fund’s investment strategy.

All of the information reviewed and analyzed by 401(k) Advisors is gathered into reports that are presented to and discussed with the fiduciaries on a periodic basis.

B. How 401(k) Advisors Helps Fiduciaries

The process used by 401(k) Advisors, as described above, helps fiduciaries meet their investment-related obligations in a number of ways:

- analyzing the appropriate investment structure for the plan by discussing with the fiduciaries their goals and objectives for the plan;
- developing the investment policy for the plan (using modern portfolio theory) through the selection of the asset classes to be used in meeting that structure;
- documenting these steps through the creation of a written investment policy statement;
- assisting in the selection of the funds to populate the designated asset classes (based on the detailed analytical tools it uses to evaluate funds and its Scorecard system) and selecting the services to assist the participants with their investment decisions;
- monitoring the investments on an ongoing basis;
- where a vendor search is warranted, working with the fiduciaries to develop the selection criteria, assisting in gathering and assessing the information provided by the vendors and helping the fiduciaries select an appropriate provider for the plan based on that detailed investigation;
- making the investigation needed for an informed decision by gathering quantitative and qualitative information and then providing the expert advice to assist in analyzing that information so that the fiduciaries can make a reasoned decision.

Indeed, we have reviewed sample monitoring reports prepared by 401(k) Advisors on the mutual funds offered in its client plans; based on our review of the work of other financial and investment advisors, these reports meet or exceed prevailing investment industry standards; in documenting due diligence, that is, the reports provided to the fiduciaries assist them in maintaining records of the process used in making decisions.

While 401(k) Advisors does not supplant the fiduciaries' independent judgment nor relieve them of the obligation to make informed and reasoned decisions, the processes employed by 401(k) Advisors and the reports it provides to fiduciaries materially assist them in satisfying their investment responsibilities under ERISA.

V. Conclusion

Under ERISA, fiduciaries have a duty of loyalty to serve the participants and a duty to act for the exclusive purpose of accumulating retirement savings safely and effectively. This obligation encompasses a number of separate tasks, including the duty to know the needs of their participants and understand their capabilities for investing; the duty to understand the services and investments that the plan currently offers, as well as those offered by other providers; the obligation to conduct a thorough investigation of relevant facts; and the duty to make informed and reasoned decisions regarding the services and investments offered by the plan.

The 401(k) Advisors process materially assists plan fiduciaries in fulfilling these responsibilities. It assists the fiduciaries in making decisions regarding the plan's investment structure, policy and specific investments, as well as services to assist the participants in their investment decisions. It assists the fiduciaries by gathering and analyzing detailed information about the quantitative and qualitative criteria needed to properly evaluate investment managers and presenting the information to the fiduciaries in a way that assists them in fund selection and monitoring. Because of this, fiduciaries should be in a position to make prudent decisions that are informed and reasoned, as required by ERISA.

VI. Footnotes

¹ The term fiduciary refers to members of the plan investment or administrative committee and other company officials with responsibility for overseeing some aspect of plan operations.

² ERISA Section 404(a)(1).

³ ERISA Section 404(a)(1)(B).

⁴ *Donovan v. Cunningham*, 716 F.2d 1455, 1467 (5th Cir. 1983).

⁵ DOL Regulation Section 2550.404a-1(b)(1).

⁶ While beyond the scope of this White Paper, the Regulation provides some explanation of “appropriate consideration,” indicating that it includes but is not limited to determining whether a particular investment or investment course of action is reasonably designed, as a part of the portfolio, to further the purposes of the plan, taking into consideration the risk of loss and the opportunity for gain, and considering the composition of the portfolio with regard to diversification, the liquidity and current return of the portfolio relative to anticipated cash flow requirements and the projected return relative to the funding objectives of the plan. DOL Regulation Section 2550.404a-1(b)(2).

⁷ *Howard v. Shay*, 100 F.3d 1484, 1488 (9th Cir. 1996).

⁸ *Liss v. Smith*, Id.

⁹ *Fink v. National Savings and Trust Company*, 772 F.2d 951, 962 (DC Cir 1984).

¹⁰ DOL Regulation Section 2509.95-1(c).

¹¹ Preamble to DOL Reg. Section 2550.404a-1. The DOL did acknowledge, however, that “it would not seem necessary for a fiduciary of a plan with assets of \$50,000 to employ, in all respects, the same investment management techniques as would a fiduciary of a plan with assets of \$50,000,000.” *See, also, Marshall v. Glass/Metal Association and Glaziers and Glassworkers Pension Plan*, 507 F.Supp. 378, 384 (DC HI 1980).

¹² *Laborers Nat. Pension Fund v. Northern Trust Quantitative Advisors, Inc.*, 173 F.3d 313 (5th Cir 1999). *See, also, In re Unisys Sav. Plan*, 1997 WL 732473 (ED Pa), *Chao v. Moore*, 2001 WL 743204 (D Md), and *In re Enron Corp. Securities*, 2003 WL 222245394 (SD Tx).

¹³ DOL Interpretive Bulletin 96-1.

¹⁴ *Lanka v. O'Higgins*, 810 F.Supp. 379 (N.D. NY 1992).

¹⁵ *Morrissey v. Curran*, 567 F.2d 546, 548-49 (2d Cir. 1977)

¹⁶ *Harley v. Minnesota Mining and Manufacturing Company*, 42 F.Supp.2d 898 (D.Minn. 1999)

¹⁷ *Tittle v. Enron*, 284 F. Supp. 2d 511 (S.D. Texas 2003).

¹⁸ DOL Reg. §2550.96-1(e).

¹⁹ While a provider of information may be highly expert in gathering and assembling data, it would not be viewed as an “expert” in the classic sense used in ERISA, where the term is generally used to refer to providers of advice, who are thus fiduciaries.

²⁰ DOL Reg. § 2509.95-1(c)(6).

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- ²¹ DOL Regulation Section 2509.75-8, Q&A FR 11.
- ²² *Gregg v. Transportation Workers of America International*, 343 F.3d 833, 843 (6th Cir 2003).
- ²³ *Liss v. Smith*, 991 F.Supp. 278, 297 (S.D.N.Y. 1998); *see also United States v. Mason Tenders Dist. Council of Greater New York*, 909 F.Supp. 882, 886 (S.D.N.Y. 1995); *Trapani v. Consolidated Edison Employees' Mutual Aid Society*, 693 F.Supp. 1509, 1516 (S.D.N.Y. 1988).
- ²⁴ *Bisceglia v. Bisceglia*, 17 F.3d 393 (9th Cir. 1994).
- ²⁵ *Id.* at 841.
- ²⁶ *Reich v. Mason Tenders District Council of Greater New York*, 909 F. Supp 882, 886 (SDNY 1995).
- ²⁷ *See, e.g., Reich v. Valley National Bank of Arizona*, 837 F.Supp. 1259 (SDNY 1993).
- ²⁸ *Bussian v. RJR Nabisco, Inc.*, 223 F.2d 286, 300-01 (5th Cir. 2000).
- ²⁹ *Donovan v. Mazzola*, 716 F.2d 1226 (9th Cir. 1983).
- ³⁰ *In re Unisys Sav. Plan Litig.*, 74 F.3d 420, 435 (3^d Cir. 1996).
- ³¹ *See, e.g., Liss v. Smith, Id.*