

FIDUCIARY ROLES AND RESPONSIBILITIES

An Overview for Committee Members

WORDS OF WISDOM

- **This seminar is not legal advice. Only your counsel can give you legal advice.**
- **Good results may keep you out of court, but a carefully documented process may allow you to prevail.**

AGENDA

- **Who is a Fiduciary?**
- **What are my duties?**
- **What is at risk?**
- **How do I protect myself and my employer from liability?**
- **How do I monitor performance objectives?**

ERISA LAW: FIDUCIARY DUTIES

SECTION 404

- **404(a): Act solely in the interest of the participants and beneficiaries**
- **404(b): Trust is in United States' jurisdiction**
- **404(c): Individual account plan investment safe harbor**
- **404(d): Plan termination rules for Fiduciaries**

INDIVIDUAL ACCOUNT PLAN INVESTMENT SAFE HARBOR: 404(C)

- **Relieves Fiduciary from the liability for any loss resulting from a participant's exercise of control over their individual account**
- **General Requirements:**
 - Participants exercise of control: Plan provides an opportunity for a Participant or Beneficiary to exercise control over assets in his/her individual account
 - Broad range of investment alternatives: Plan provides a Participant an opportunity to choose among investment alternatives

WHO IS AN ERISA FIDUCIARY?

Fiduciary:

- **Has discretionary authority over Plan investments**
- **Exercises any control over Plan assets**
- **Gives investment advice for compensation**
- **Has any discretion over Plan management or administration**

WHO IS AN ERISA FIDUCIARY (CONT.)?

- **Named Fiduciaries**
- **Fiduciaries by position:**
 - Retirement Committee
 - Trustee
 - Investment Manager and Investment Advisor
- **Functional definition of additional Fiduciaries**

WHAT MUST I DO AS A FIDUCIARY?

- **Duty of loyalty to Plan Participants and Beneficiaries**
- **Duty of prudence in carrying out responsibilities**
- **Duty of diversification for Plan investments**
- **Duty to follow Plan documents**

FIDUCIARY RESPONSIBILITIES: ACT SOLELY IN THE INTEREST OF THE PARTICIPANT

- **Discharging of duties with respect to the Plan solely in the interest of Participants, and**
- **For the exclusive purpose of:**
 - Providing benefits to the Participants and Beneficiaries
 - Defraying reasonable expenses of administering the Plan

FIDUCIARY RESPONSIBILITIES: ACT WITH PRUDENCE

- **Prudent Expert Rule**

- “With the care, skill, prudence, and diligence...that a prudent man acting in a like capacity and familiar with such matters would use...” *

* ERISA 404(a)(1)(B)

FIDUCIARY RESPONSIBILITIES: OFFER BROAD RANGE OF INVESTMENTS

- **Diversify the assets of the Plan so as to minimize the risk of large losses**
- **At least three materially different options**
- **Act in accordance with Plan document, Investment Policy Statement, and applicable law**

FIDUCIARY RESPONSIBILITIES: DUTY TO FOLLOW PLAN DOCUMENTS

- **Plan Fiduciaries must oversee the Plan in compliance with the Plan document, trust agreement, and other documents**
- **You must therefore be familiar with the documents that govern your duties**
- **You must also be familiar enough with the laws to know what it requires in case there is a conflict**

FIDUCIARY LIABILITY

- **Fiduciary may be personally liable for any losses to the Plan resulting from a breach of Fiduciary duty**
- **Breaches:**
 - Failure to fulfill Prudent Expert standard
 - Failure to monitor or act
 - Prohibited transactions (excise / penalty taxes)

Delegation and Expert Assistance

- May hire Investment Managers, Administrators, and Advisors, but must select them prudently and monitor their performance
- Retirement plans are complicated – hire Legal Counsel when necessary
 - Plan documents
 - Contracts and agreements
 - General fiduciary advice

Fiduciary Insurance and Bonding

- May purchase fiduciary liability insurance
- Obtain employer's indemnification for personal liability arising from duties as Committee Member
- The fiduciary bond required by ERISA protects Plan Beneficiaries from misuse of Plan assets by Fiduciaries, not the Fiduciaries themselves

404(c) Disclosures

- Description of investments, including risk and return characteristics
- How investment instructions may be given
- Transaction fees and expenses
- Contact information of fiduciary responsible for supplying this information
- Prospectus for registered securities following purchase and materials relating to voting shares (if such rights are passed through to participant)

FIDUCIARY STANDARDS

- **Performance standard: Outcome or process based?**
- **Procedural prudence defined:**
 - Giving appropriate consideration to those facts and circumstances that the Fiduciary knows or should know, are relevant to the particular investment or investment course or action involved
 - Acting accordingly

RISK MANAGEMENT TOOLS

- **Documentation**
- **Delegation/expert assistance**
- **Fiduciary insurance and bonding**
- **ERISA Section 404(c)**

DOCUMENTATION

- **Documentation and maintenance of good records:**
 - Charter
 - Investment Policy Statement
 - Minutes of actions or decisions
 - Supporting documents and data

DOCUMENTATION (CONT.)

- **Keep a due diligence file of information used to make decisions, including notes from Committee meetings**
 - Consider relevant facts and circumstances
 - Follow a prudent process (Investment Policy Statement)
 - Implement results of the process
 - Liability usually comes from bad processes, not bad decisions

INVESTMENT POLICY CONTENT

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

How does your Committee deal with underperformance and terminations?

IMPORTANCE OF INVESTMENT POLICY

- **Do you have an Investment Policy?**
- **Is it a sound policy?**
- **Do you follow it?**
- **When was it last reviewed?**

INVESTMENT PROCESS

- **Do you have a Committee?**
- **Who sits on your Committee?**
- **How often do you meet?**
- **What is the process for monitoring and evaluating investments?**
 - Recordkeeper benchmarks
 - Investment Advisor
 - Others
- **Investment structure**

INVESTMENT MANAGER REVIEW

Typical Allocation of Responsibilities:

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

INVESTMENT MANAGER REVIEW

- **Fund Check Up**

- Peer group comparisons
- Index benchmark comparison

Example:

Large Cap Core Manager:

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

INVESTMENT MANAGER REVIEW

- **Manager Case Study – Peer Group Rankings Actionable or Informational**
- **Top Quartile Manager Analysis by Dimeo Schneider (as of 12/31/09)**

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

INVESTMENT MANAGER REVIEW

Actionable Information - Diagnostics:

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

INVESTMENT MANAGER REVIEW

- **Diagnostic Results**
- **Performance Consistency Question**

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	YTD
Dodge & Cox Balanced	10.05%	-2.94%	24.44%	13.30%	6.59%	13.86%	1.73%	-33.57%	28.37%	12.22%	-1.66%	9.85%
Peer Group % Rank	3	4	17	5	23	13	90	89	23	43	69	6
Peer Group % Return	-5.05%	-12.02%	20.35%	8.86%	5.13%	11.29%	5.99%	-28.00%	24.13%	11.83%	-0.11%	7.83%

*Morningstar data as of (5/1/2012)

Dodge and Cox Balanced - Key Observations:

- Underperformance isolated to 2007 and 2008. Fixed Income began to derail in 2007.
- 2008 - Represented a complete Equity and Fixed Income dislocation during the crisis.
- 2007 - Beginnings of market move to quality (Government Securities) on Fixed Income.
- 2008 - Full fledged flight to quality fixed income and equities.
- Performances has been consistently strong relative to peer group with the exception of 2007 and 2008.
- Manager team tenure more than 10-years – Process / philosophy consistent.
- Investment expense at 0.53% - well below the class average of 1.02%.

INVESTMENT MANAGER REVIEW

Observations:

• Equities

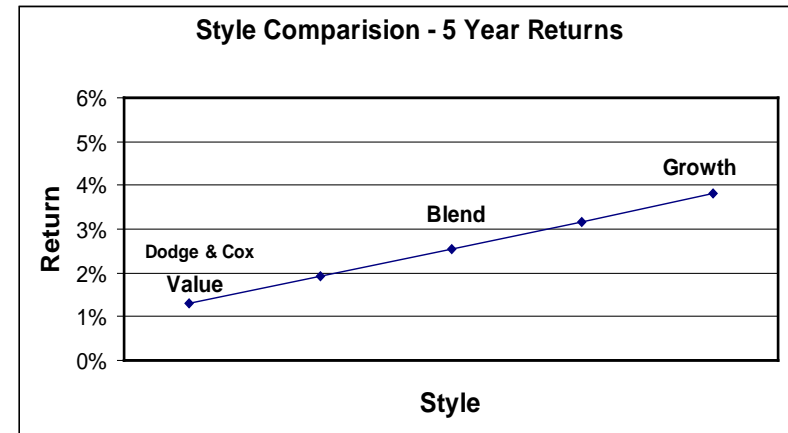
- Investment style: Dodge & Cox is a value style.
- Long-term (rolling 20-Year periods style is neutral).
- Shorter-term style rotation occurs between growth and value.
- Trailing 5-years growth has been in favor.

• Fixed Income Asset Allocation

- Dodge & Cox average credit quality is A to BBB - Index is AA.
- Dodge & Cox sector allocation weighted heavily to non-governmental - index much heavier to governmental.
- These factors, while over the long-term have worked well for the fund during 2007 and 2008, they contributed to significant underperformance.

• Other

- Risk reward ratios: Sharpe ratios positive across all time periods, exceed peer group for longer time periods. Standard Deviation / Beta are typically greater than benchmark.



Fixed Income Data

Credit Quality			Sector Allocation		
	Fund	Index		Fund	Index
AAA	47%	75%	Govt.	2%	41%
AA	8%	3%	Mort	46%	37%
A	10%	11%	Corp	39%	17%
BBB	18%	9%	Asset Backed	4%	0%
BB	9%		Muni	5%	1%
B	5%		Foreign	4%	4%
Below B	3%	2%	Totals	100%	100%
Totals	100%	100%			

Expenses, Revenue and Fees

- Transparency
- Reasonableness
- Competitiveness

Expenses, Revenue and Fees

Fund	Assets	% of Assets	Expense Ratio	Expense \$	Rev Share	Rev \$
Capital Preservation						
Stable Value	\$10,000,000	50.0%	0.35%	\$35,000	0.20%	\$20,000
Fixed Income						
Total Return	\$750,000	3.8%	0.68%	\$5,100	0.25%	\$1,875
Bond Index	\$750,000	3.8%	0.20%	\$1,500	0.00%	\$0
Target Date Portfolios						
Ret Inc TRD Portfolio	\$500,000	2.5%	0.48%	\$2,400	0.25%	\$1,250
2010 TRD Portfolio	\$500,000	2.5%	0.64%	\$3,200	0.25%	\$1,250
2020 TRD Portfolio	\$750,000	3.8%	0.72%	\$5,400	0.25%	\$1,875
2030 TRD Portfolio	\$750,000	3.8%	0.76%	\$5,700	0.25%	\$1,875
2040 TRD Portfolio	\$550,000	2.8%	0.79%	\$4,345	0.25%	\$1,375
2050 TRD Portfolio	\$500,000	2.5%	0.82%	\$4,100	0.25%	\$1,250
Large Cap						
Large Cap Growth	\$500,000	2.5%	0.94%	\$4,700	0.35%	\$1,750
Large Cap Value	\$500,000	2.5%	0.96%	\$4,800	0.35%	\$1,750
Large Cap Blend Index	\$500,000	2.5%	0.10%	\$500	0.00%	\$0
Mid Cap						
Mid Cap Growth	\$400,000	2.0%	0.98%	\$3,920	0.35%	\$1,400
Mid Cap Value	\$400,000	2.0%	1.10%	\$4,400	0.25%	\$1,000
Mid Cap Blend Index	\$400,000	2.0%	0.20%	\$800	0.00%	\$0
Small Cap						
Small Cap Growth	\$250,000	1.3%	1.13%	\$2,825	0.35%	\$875
Small Cap Value	\$250,000	1.3%	0.98%	\$2,450	0.25%	\$625
Small Cap Blend Index	\$250,000	1.3%	0.23%	\$575	0.00%	\$0
International						
International Growth	\$500,000	2.5%	0.75%	\$3,750	0.25%	\$1,250
International Value	\$500,000	2.5%	0.98%	\$4,900	0.35%	\$1,750
International Index	\$500,000	2.5%	0.20%	\$1,000	0.00%	\$0
Grand Total	\$20,000,000	100.0%		\$101,365		\$41,150
			Weighted Average	0.51%		0.21%

Fiduciary's Next Steps

- Organize Plan governance documents
- Have a process:
 - Investments
 - Fees
- Exercise loyalty
- Apply prudence
- Document the process

QUESTIONS?