HYAS GROUP
— INVESTMENT ADVISORS —

FIDUCIARY FUNDAMENTALS

CITY OF SAN JOSE

DCAC and VAC Meetings

June 27, 2022

BACKGROUND: ABOUT ERISA

- 1974: Employee Retirement Income Security Act
  - Ford Administration
  - Enacted on Labor Day
- Why?
  - Abuses of existing law by some firms and unions
  - Assets being misused
  - Ten-year "Cliff Vesting" resulting in many never gaining a pension
  - Confusion of conflicting state laws
- The result is an approach that blends state trust laws to form a national standard for benefit plan definition and administration
- For the public sector, provides for best practices and accepted methods for plan design and operation

WHO IS A FIDUCIARY?

- Fiduciary by name:
  - Plan Sponsor
  - Trustee(s)
  - Administrator

- Fiduciary by action:
  - A Committee appointed by the Board
  - Anyone giving investment advice for a fee
  - Anyone with discretionary authority or control over the administration of a retirement plan or its assets

WHAT IS A RETIREMENT PLAN FIDUCIARY?

- Persons who, by either function or appointment, have discretionary authority over plan assets and/or administration
- Fiduciary functions:
  - Selecting, retaining or terminating record-keepers/ plan administrators
  - Selecting, retaining, or terminating investment options
  - Processing and submitting participant contributions
  - Negotiating fees and expenses for plan services and investment
- Must be more than "ministerial"
  - Maintaining records and other administrative roles are not covered

FIDUCIARY DUTIES

DUTY OF LOYALTY:

1. Act solely in the best interests and for the exclusive benefit of plan participants
2. Defray plan expenses in a reasonable manner
3. No self-dealing

DUTY OF PRUDENCE:

1. Act with care and diligence of an expert
2. Procedural prudence–follow a prudent/reasonable process
3. Diversify investments to minimize the risk of large losses

DUTY TO FOLLOW PLAN DOCUMENT:

1. Comply with federal and state laws
2. Operate the plan in accordance with the written plan document

DUTY OF LOYALTY

- Must not place own interests over those of the participant
- Avoid self-dealing
- Must not cause the plan to engage in transactions between the plan and a party in interest:
  - Parties in interest: Fiduciaries, trustees, plan counsel, employees or related persons
- Operate the plan for the exclusive purpose of providing benefits and offsetting reasonable expenses
- Plan expenses may be charged to the plan and it is the fiduciary's responsibility to decide which expenses to charge and whether they are reasonable
- Regulators have issued guidance on what might constitute an appropriate plan expense, but they have been very limited in their guidance of what would be considered reasonable

DUTY OF PRUDENCE

- A fiduciary must execute his/her duties with the care, skill, prudence, and diligence under the prevailing circumstances that a prudent person acting in a like capacity and familiar with such matters would use:
  - Referred to as the "prudent expert" rule because of the familiarity assumption
  - Follow a prudent process (procedural prudence concept)
  - Allows for the hiring of "experts" to assist
  - Experts must be prudently selected and monitored
- A fiduciary must diversify the investments in the plan to minimize the risk of large losses unless, under the circumstances, it is clearly prudent not to do so

DUTY TO FOLLOW PLAN DOCUMENTS

- Must oversee and make sure the plan operates in compliance with the plan document, trust agreements and/or relevant other documents
- Fiduciaries should be familiar with:
  - Plan documents
  - Federal and state law in relations to the documents

FIDUCIARY BEST PRACTICES: PLAN GOVERNANCE

› Form a Committee and select and train qualified people to serve

› Establish roles, rules and procedures for Committee functions

› Hold regular meetings

› Follow a prudent process when making decisions

› Document decisions and keep minutes of fiduciary meetings

SUMMARY OF COMMITTEE FUNCTIONS & RESPONSIBILITIES

- Review of investments
- Fiduciary review of service providers
- Authorize changes to investments
- Authorize changes to investment providers
- Create or approve design of education/counseling programs
- Review and approval of hardship withdrawal requests or appeals
- Monitoring of fees and expenses

PLAN DESIGN & ADMINISTRATION ISSUES

- Design the plan and fee allocation to be fair to all participants
- Establish appropriate rules and policies for participants
- Enforce plan rules consistently
- Communicate rules, policies, and amendments to participants
- Review plan documents at least annually to ensure compliance
- Review trust, custodial, and other service agreements regularly

INVESTMENT RESPONSIBILITIES

- Maintain an Investment Policy Statement (IPS) that reflects the plan objective and clarifies the responsibilities of all parties
- Determine types of investment options to be offered:
  - Number of asset classes
  - Diversification
  - Target-date funds
  - Managed accounts
- Develop criteria for selecting, monitoring and removing investments and investment managers/advice providers
- Set guidelines for appropriate actions

SELECTION & MONITORING OF SERVICE PROVIDERS

- All contracts should be in best interest of plan participants
- Competitive bid or search process should be based on objective criteria
- Follow a prudent process and be able to justify contract awards
- Establish appropriate performance standards
- Evaluate contractors regularly
- Have reasonable basis for determining appropriateness of provider fees:
  - Benchmarking
  - RFP

RISK & PROTECTION FOR FIDUCIARIES

- What is at risk?:
  - Cost of fiduciary breach
  - Penalties and taxes
  - Personal liability
  - Public relations problems

- Plan document /plan sponsor should protect fiduciaries from personal liability to the extent allowed by law:
  - State law may provide certain protections
  - Seek indemnification from employer
  - Evaluate fiduciary insurance and bonding needs

THANK YOU

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