Strategic Benefit Services

SEVEN REASONS FOR HIRING A DEDICATED RETIREMENT PLAN ADVISOR

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Fiduciaries of employer-sponsored retirement plans hire a Retirement Plan Advisor to meet their responsibilities under the Employee Retirement Income Security Act (ERISA) and to improve the probability that their employees' retirement investment goals will be achieved. A Plan Advisor that is dedicated to retirement keeps abreast of changes in the industry and in the regulatory environment and interprets all relevant developments for its clients. The Plan Advisor creates a custom set of processes and prudent practices for its clients to achieve their goals for the retirement plan benefit.

Plan Advisors are hired to serve at least seven major functions:

1. Help the institution meet its fiduciary duty.
2. Establish investment policies and procedures.
3. Manage a Request-for-Proposals (RFP) for service providers.
4. Conduct investment manager search and selection.
5. Replace an investment manager.
6. Manage investment performance reporting.
7. Conduct ongoing due diligence on service providers and investment managers.

Each function is discussed briefly in the pages that follow.

1. Meeting Fiduciary Duty

Fiduciaries are expected to apply the standards of a prudent expert in their investment decisions. If the fiduciaries do not possess the required level of investment expertise they may hire a Plan Advisor to meet this standard. Hiring a Plan Advisor does not eliminate potential fiduciary liability, as the fiduciaries must closely monitor the services of the Plan Advisor.

The consequences of imprudent investment decisions and the potential fiduciary liability vary according to the type and purpose of the trust. Fiduciaries of endowments and foundations are subject to state law. Most states have adopted prudent investor legislation, which sets forth the standards and expected practices of fiduciaries. Often, fiduciaries' main concern and motivation for hiring a Plan Advisor is avoidance of legal action that can be brought against them as individuals.

Defined benefit pensions, which are subject to ERISA, carry more serious potential consequences for fiduciaries. ERISA sets forth expected practices for fiduciaries in very detailed language. Fiduciaries who are unaware of, or choose to ignore ERISA standards, increase the possibility of having to defend themselves (individually) in a civil lawsuit. Plan Advisors who are hired by defined benefit plans that fall under ERISA serve their clients well by educating them on their fiduciary role and by establishing fully documented procedures to ensure compliance. An example of such documentation is formal meeting minutes for all meetings of the fiduciaries.

2. Establishing Investment Policies and Procedures

A well written investment policy statement (IPS) provides the framework for consistent investment decisions. Early in the relationship, the Plan Advisor will review the existing policies. In the absence of existing policies, the Plan Advisor will provide an IPS to the institution. Standard IPS language encompasses the topics shown in the table below:

Standard Items Appearing in an Investment Policy Statement

1. Identification of the retirement plan, participants, and fiduciaries.
2. A statement of purpose for the IPS.
3. Identification of the various service providers (not necessarily the firm names), with descriptions of their roles, responsibilities, and deliverables to fiduciaries. Service providers may include: the Plan Advisor, record keeper, administrator, custodian, directed trustee, and actuary.
4. Listing of approved asset classes, with a relevant industry benchmark index for each.
5. Listing of restricted investments, at the fiduciaries discretion (e.g. tobacco, alcohol, firearms, or gambling).
6. For fiduciary-directed investment portfolios, a statement of asset allocation policy and rebalancing guidelines.
7. Listing of investment manager search, selection, and retention criteria.
8. Description of the replacement process or "watch list" for managers who no longer meet the selection/retention criteria.
9. Statement of frequency of investment performance reviews, and general communications procedures for the service providers.

The IPS should be written in language that gives the fiduciaries latitude to use their best judgment in a given set of circumstances. Rigid investment policies that are not followed could be used against the fiduciaries in a court of law. The Plan Advisor should review the IPS with the fiduciaries at least every two years, or pursuant to significant regulatory changes.

3. Managing a Request-for-Proposals for Service Providers

The Plan Advisor's knowledge of the investment industry makes it the logical choice to manage a request for proposals (RFP) for other service providers, such as custodian or directed trustee. The Plan Advisor's role in the RFP includes:

- develop the questions contained in the RFP;
- identify qualified firms to receive the RFP;
- act as the institution's main contact with all responding firms, which is essential when the institution wishes to remain anonymous in a "blind" RFP;
- analyze responses to the RFP;
- prepare and present a summary analysis of the responses;
- recommend a course of action to the institution; and
- facilitate the transition to the new service provider.

4. Investment Manager Search and Selection

The Plan Advisor conducts a search for a best-in-class investment manager for each of the asset classes identified in the asset allocation policy section of the IPS. Applying the qualitative and quantitative selection criteria as a filter, the Plan Advisor produces a list of potential managers. The Plan Advisor presents a list of four to five finalist firms to the institution with a recommendation for the best firm. The Plan Advisor provides ongoing due diligence on the managers that are hired by comparing the managers' fund statistics against the original selection criteria. This is done no less frequently than quarterly. The Plan Advisor monitors and reports on changes in qualitative criteria, including firm ownership, key personnel changes or adverse litigation/regulatory issues.

5. Investment Manager Replacement

The Plan Advisor's due diligence on investment managers may reveal a manager that no longer meets the selection criteria in the IPS. The Plan Advisor should notify the institution on a timely basis and the specific criteria under which the manager is deficient. Depending on the number of selection criteria deficiencies and severity of the problem, the Plan Advisor will recommend that the manager be placed "under review" or be immediately replaced. When a manager is placed under review or on a watch list, the Plan Advisor heightens due diligence, focusing on the criteria where performance fails to meet minimum standards. For example, the IPS selection criteria may state that a large cap growth manager's performance must consistently meet or exceed the annualized trailing three-year and five-year returns of the Russell 1000 Growth Index. When a large-cap growth manager fails to meet these criteria, the Plan Advisor will perform attribution analysis in an effort to understand the reasons for the underperformance.

Attribution analysis can be done at both the sector and individual security levels, to determine the nature of the manager's underperformance. When a manager is placed under review, there should be a clear understanding among the fiduciaries and the Plan Advisor that this is only a temporary status. The best practice would be for the Plan Advisor to do all the necessary research on a manager under review as soon as possible. Then the Plan Advisor presents this information to the institution with a recommendation to either remove the manager from "under review" status or commence a manager-replacement search.

Situations sometimes arise where the need to replace a manager is obvious. A common reason for manager replacement is a significant shift in investment style. Also known as "style drift," this can undermine the institution's asset-allocation strategy. For instance, when a small-cap manager "drifts" into the mid-cap segment of the market, it creates both a gap and a potential redundancy in the portfolio's asset allocation. The process to replace a manager is similar to the original search and selection process, except that the performance analysis compares the incumbent manager with the replacement candidates and the benchmark index. Manager replacement can be challenging for the fiduciaries, even with a well-written IPS as a guide. It is an important decision, and as with all fiduciary actions, the process should be fully described and documented in the institution's records.

6. Performance Reporting

A comprehensive investment performance report is essential for fiduciaries' prudent investment decisions. The Plan Advisor generally produces performance reports and makes a presentation to the fiduciaries on a quarterly basis. Performance reports normally include information such as that listed in the table below.

Typical Items Appearing in Performance Reports

1. An economic/market review.
2. A status report on any manager replacements, watch list, additions, or terminations.
3. A "scorecard" (summary, plus supporting detail) comparing each investment's performance with the standards in the IPS.
4. Disclosure of investment-related fees (expense ratios).
5. Investment profiles or fact sheets.

The following only applies to retirement participant-directed investments:

1. Dollar amount invested in each investment option, plus percentage of the entire plan.

The following only apply to fiduciary-directed investment portfolios:

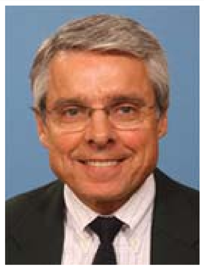
1. The portfolio's current asset allocation versus the target asset allocation stated in the IPS.
2. A narrative on portfolio and asset class performance, to identify portfolio components that added to or detracted from overall performance.
3. A consolidated portfolio performance report in executive summary format.
   - The portfolio's historical performance versus a custom benchmark index.
   - The performance of broad segments of the portfolio versus relevant indexes.
   - The dollar amounts invested with each manager.
   - An analysis of portfolio risk characteristics using Modern Portfolio Theory conventions.
   - Summary of investment expenses and a liquidity schedule for each manager.
   - Disclosure of each manager's legal and accounting firms.

7. Conduct Ongoing Due Diligence on Service Providers and Investment Managers

The Plan Advisor stays well informed on meaningful developments across a broad spectrum of topics that have the potential to affect the service providers' ability to deliver quality services (e.g., financial strength, change in ownership/management, and adverse litigation). Due diligence on investment managers entails: studying public information/filings, shareholder communications, prospectus/offering circulars, and annual shareholder reports. The Plan Advisor reports any meaningful developments to the fiduciaries, and if necessary, with a recommendation for a prudent course of action.

This article has examined the range of professional services that a Plan Advisor can offer to fiduciaries of an employer-sponsored retirement plan. It is intended to raise awareness on the part of plan fiduciaries of the type of support they could expect by engaging a Plan Advisor. Plan Advisor services are highly customizable. A typical client-advisor relationship begins with a review of the status quo for the plan. The initial review helps establish the client's goals, set the parameters of the engagement, and prioritize tasks within the project.

About The Author



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