The responsibility and personal liability of retirement plan fiduciaries are an ever-growing weight around the necks of corporate directors and officers. A new fiduciary model lifts the burden.
Today’s retirement plan fiduciaries face a number of impossible contradictions. ERISA requires they act as “prudent experts.” Yet few corporate directors and officers claim expertise in retirement plan oversight. Often unknowingly, they can assume personal liability for fiduciary decisions. Yet few directors and officers can oversee or participate in the decisions that might trigger a claim of fiduciary breach. They must have the space to focus on their “real jobs” as corporate directors and officers. Yet the rapidly rising complexity of fiduciary activity chokes off problem-solving capacity at senior levels. They are being sued to reduce plan expenses — and their investment decisions are being questioned. So to protect themselves plan sponsors hire an army of consultants and advisors — which increases costs and cuts net investment returns.

The consequences are inevitable. Complexity grows. Returns shrink. Costs and the risks of litigation mount. Corporate leadership is distracted. And performance suffers. Bad results cause bad actions that cause more bad results in a vicious downward spiral. Caught in a fundamentally flawed business model, corporations and retirement plans pay ever-higher fees and expenses with little comfort either in reducing fiduciary risks or enhancing fiduciary processes. Yet even as its clients have suffered, the retirement industrial complex has flourished.

The Harrison Fiduciary Group (HFG) proposes a different model — where an outside prudent expert assumes the investment fiduciary role. This achieves three objectives:

- Reduce or redeploy internal staff resources dedicated to fiduciary tasks, specifically retirement plan management and oversight;
- Reduce plan expenses thereby potentially increasing investment returns; and
- Reduce fiduciary risks of corporate directors and officers through disciplined corporate governance and oversight.

The model requires the integration of skills rarely combined in any organization. These skills include the legal, investment management, and prudent judgment sides of the fiduciary role. Today, too many financial professionals grasp at the fiduciary label. Stock brokers, investment advisors and investment consultants often wrap themselves in the mantle of Fiduciary. But few of these firms have fiduciary principles baked into their DNA. A good fiduciary upholds the highest standards of trust and confidence. That is “good” both in terms of investment results and in terms of prudent conduct. The fact remains: any decision an investment fiduciary makes has both investment and fiduciary implications that must be viewed simultaneously by prudent experts. Such experts would only be found in a firm specifically set up to offer that specialized blend of expertise.
That outside firm must also do more than just advise. The firm must be ready to implement its ideas and stand accountable for these decisions. For the firm’s expertise to be relevant, the client should feel comfortable delegating the widest scope of authority to the firm. Potentially that means becoming the sponsor’s investment named fiduciary, which is where the fiduciary “buck” stops. HFG’s model therefore allows transfer of the investment named fiduciary role itself to a more suitable location – i.e., to a firm appropriately equipped to perform it.

WHAT DO I GIVE AWAY? WHAT DO I KEEP?

The question of how much, if any, of the fiduciary role a particular sponsor should delegate to a fiduciary firm requires an understanding of the various tasks and responsibilities that go into running a retirement plan – outlined in Table 1.

<table>
<thead>
<tr>
<th>Responsibility</th>
<th>Whose role?</th>
<th>Fiduciary Status?</th>
<th>Example Tasks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Settlor</td>
<td>Board</td>
<td>No</td>
<td>• Establish type of plan (pension, 401(k), etc)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Set plan terms: vesting, distributions</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Determine benefit formulas</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Specify named fiduciaries in plan docs</td>
</tr>
<tr>
<td>Administrative</td>
<td>Human Resources (Often outsourced to 3rd party administrator)</td>
<td>No</td>
<td>• Maintain database of plan participants and beneficiaries, including employment history</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Communicate with participants</td>
</tr>
<tr>
<td></td>
<td>Benefits Committee</td>
<td>Yes</td>
<td>• Interpret plan terms: e.g. eligibility</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Evaluate benefit claims</td>
</tr>
<tr>
<td>Corporate Finance</td>
<td>Corporate Finance</td>
<td>No</td>
<td>• Affirm plan actuarial assumptions</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Determine yearly plan contributions</td>
</tr>
<tr>
<td>Investment Management</td>
<td>Investment Committee</td>
<td>Yes</td>
<td>• Hire/monitor/fire independent investment managers</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Select investment options</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Approve fees and expenses</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Set strategic allocation decisions</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Determine risk profile and risk factors</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Select investment styles (e.g., growth, value)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Allocate among asset classes (e.g., bonds, equities)</td>
</tr>
</tbody>
</table>

TABLE 1: ALLOCATION OF RESPONSIBILITIES, ROLES AND TASKS IN AN ERISA QUALIFIED PLAN
As measured by level of responsibility, liability and complexity, by far the greatest “weight” on plan sponsors lies with the investment of plan assets. The named investment fiduciary is responsible and personally liable for investment fiduciary practices and outcomes. Administrative tasks, such as preparing plan documents and reports, also add weight although they are not technically fiduciary. Even there, however, an outside named fiduciary can assist; for example, by providing content specifically related to investment strategies, activities and outcomes.

Finally, an autonomous investment named fiduciary could serve as an impartial and knowledgeable sounding board for directors and corporate finance professionals regarding plan structures, terms, investing strategies and funding requirements. An autonomous investment named fiduciary is not responsible for those decisions. However, given its general knowledge of the plan’s risk parameters, the market environment and fiduciary principles, it is well positioned to counsel those who are responsible.

Congress has established complicated new rules with respect to the valuation and funding of pension liabilities. The independent named fiduciary would collaborate with the plan sponsor in determining funding levels consistent with the new rules and the risk profile/asset allocation of the plan.

What then is the division of labor should the outside firm assume full investment named fiduciary status? Table 2 offers a summary:

<table>
<thead>
<tr>
<th>Tasks Corporation Continues To Perform</th>
<th>Tasks Corporation Delegates</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ Set plan structure &amp; terms*</td>
<td>▪ Set strategic allocation decisions</td>
</tr>
<tr>
<td>▪ Devise corporate governance structure*</td>
<td>▪ Determine risk profile and risk factors</td>
</tr>
<tr>
<td>▪ Specify named fiduciaries in plan docs</td>
<td>▪ Choose investment styles (e.g., growth, value)</td>
</tr>
<tr>
<td>▪ Select plan type, e.g., 401(k)</td>
<td>▪ Allocate among asset classes (e.g., bonds, equities)</td>
</tr>
<tr>
<td>▪ Determine benefit formulas</td>
<td>▪ Decide investment philosophies (e.g., index, quantitative)</td>
</tr>
<tr>
<td>▪ Decide payout terms</td>
<td>▪ Execute on investment strategies / philosophies</td>
</tr>
<tr>
<td>▪ Set vesting terms</td>
<td>▪ Hire/monitor/fire independent investment managers</td>
</tr>
<tr>
<td>▪ Determine participant eligibility</td>
<td>▪ Select Investment Options</td>
</tr>
<tr>
<td>▪ Communicate with participants*</td>
<td>▪ Approve fees and expenses</td>
</tr>
<tr>
<td>▪ File reports with IRS and DOL*</td>
<td></td>
</tr>
<tr>
<td>▪ Determine yearly plan contributions*</td>
<td></td>
</tr>
</tbody>
</table>

* These tasks are not fiduciary, in nature, but the independent fiduciary could offer advice based upon its industry experience and knowledge.

TABLE 2: DIVISION OF LABOR BETWEEN THE CORPORATION AND OUTSIDE NAMED FIDUCIARY

In short, an outside investment named fiduciary would collaborate with internal professionals and outside consultants on establishing an Investment Policy Statement, asset allocation strategy and investment objectives structured to respond to the particular projected liability needs of the company. Furthermore,
the investment named fiduciary would hire and oversee all investment consultants, investment managers and investment options, assuring that plans receive the benefit of best industry practices at reasonable and very competitive fees. In addition, the firm would review, monitor and renegotiate a plan’s relationships with its trustee, administrator and recordkeeper. On a regular basis, the firm would also provide comprehensive professional reports to senior management or, if appropriate, to the directors of the corporation.

Nor is it just activity that is being pushed outside. Fiduciary risk is, too. The outside firm establishes a “best practices fiduciary zone” around delegated areas where little gets inside that’s inconsistent with good corporate governance. Significant “risk reducers” are: (1) having a single point of control over what is otherwise typically a disaggregated assemblage of consultants and advisors; (2) a corporate governance structure that clearly delineates fiduciary roles and activities, and: (3) maintaining proper written policies and procedures that comply with relevant statutes and regulations.

Even though litigation has increased dramatically in recent years (for reasons to be discussed shortly), courts have routinely held in favor of defendant fiduciaries that have discharged their fiduciary responsibilities by following written policies and procedures. That’s good news for corporate directors and officers who might otherwise face greater legal jeopardy.

WHAT ABOUT RISK MANAGEMENT ALLOCATION?

Legal risk is in fact just part of the risk that an Investment Named Fiduciary can help shoulder on behalf of the plan sponsor.

In January 2009, MetLife published the MetLife U.S. Pension Risk Behavior Index that identifies 16 specific risk factors raised by the sponsorship of a defined benefit plan. In other words, retirement plans, designed as a benefit to attract and retain employees, saddles directors and managers with 16 identifiable risks they must monitor and manage with or without outside help.

Table 3, for example, shows the allocation of managing the 16 risk factors when a plan sponsor hires HFG as the Investment Named Fiduciary. Absent HFG, the plan sponsor manages these risks alone. With HFG as a fiduciary, many of these risks are managed solely by HFG or in conjunction with HFG.
As the chart reflects, upon hiring HFG as an Investment Named Fiduciary, HFG will manage three-quarters of the risks identified with plan sponsor either solely or in collaboration with the plan sponsor.

<table>
<thead>
<tr>
<th>Type of Risk</th>
<th>Management Responsibility</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>HFG</td>
</tr>
<tr>
<td>Asset Allocation</td>
<td>•</td>
</tr>
<tr>
<td>Meeting Return Goals</td>
<td>•</td>
</tr>
<tr>
<td>Ability to Measure Risk</td>
<td>•</td>
</tr>
<tr>
<td>Negative Alpha</td>
<td>•</td>
</tr>
<tr>
<td>Fiduciary Risk &amp; Litigation Exposure</td>
<td>•</td>
</tr>
<tr>
<td>Investment Valuation</td>
<td>•</td>
</tr>
<tr>
<td>Advisor Risk</td>
<td>•</td>
</tr>
<tr>
<td>Inappropriate Trading</td>
<td>•</td>
</tr>
<tr>
<td>Underfunding of Liabilities</td>
<td>•</td>
</tr>
<tr>
<td>Asset &amp; Liability Mismatch</td>
<td>•</td>
</tr>
<tr>
<td>Plan Governance</td>
<td>•</td>
</tr>
<tr>
<td>Decision Process Quality</td>
<td>•</td>
</tr>
<tr>
<td>Quality of Participant Data</td>
<td>•</td>
</tr>
<tr>
<td>Longevity Risk</td>
<td>•</td>
</tr>
<tr>
<td>Mortality Risk</td>
<td>•</td>
</tr>
<tr>
<td>Early Retirement Risk</td>
<td>•</td>
</tr>
</tbody>
</table>

**TABLE 3: INVESTMENT NAMED FIDUCIARY**

But again, fiduciary status is not an all or nothing proposition. An independent fiduciary performs a subset of named fiduciary tasks rather than all of them.
Based on their specific needs, sponsors might well wish to “dial up” only as much fiduciary protection as needed. Tasks of an independent fiduciary can include:

- Oversight of stable value programs
- Managing company stock accounts
- Directing litigation involving the plan, including approving litigation settlement offers
- Managing and assessing securities lending programs
- Approving plan expenses for service providers
- Assessing and monitoring asset pricing and valuation processes

An independent fiduciary can be especially helpful in any situation where a plan sponsor, or other fiduciary, could be subject to a claim of self-dealing or engaging in a conflict of interest.

WHY SO HEAVY?

Corporations of course would have little reason to delegate away any fiduciary tasks if the stakes were low, the tasks easy or the consequences for mistakes negligible. The reality is just the opposite. Within the S&P 500, 56 companies now have pension liabilities exceeding 50% of the company’s market capitalization, and 17 of these companies shoulder pension obligations that exceed their entire market capitalization. The complexity of managing such huge investments is also huge, as measured in the rapidly rising number of asset classes, investment managers and investment management specialties. And while the entire investment manager industry has grown increasingly specialized – with managers ever more focused on investment processes and investment returns – fewer have been focused on overall fiduciary processes and principles.

These trends – historic asset growth, greater investment complexity and specialization, and a limited focus on fiduciary process and principles – have not occurred in a vacuum. At the same time, there’s also been profound distrust of plan sponsors on the part of plan beneficiaries – given the recent near universal collapse of 401(k) accounts. A recent survey found that 60% of investors feel financial service providers offer, “Products that are in their own best interests, rather than those of their clients.” Stunningly, 49% of the US-based providers agreed with the investors’ assessment.

Increasingly that distrust is expressed as lawsuits in an environment that has suddenly become more tolerant of plaintiff filings. That’s partly due to a February
2008 Supreme Court ruling that expanded the scope of potential ERISA claims. Prior to the ruling, employees could only sue on behalf of the plan, not themselves. Also, there were no monetary damages for individual claims arising from breach of fiduciary duty. After the ruling, however, individuals can hold fiduciaries personally liable for plan losses resulting from breaches of fiduciary duties – and can collect monetary damages.

The result of all these trends is predictable. Not long ago ERISA class action litigation was a little noticed backwater for plaintiff’s lawyers. Now, ERISA claims often serve as a prelude to securities law claims and have become a primary weapon for plaintiff’s lawyers as they aggressively pursue corporate officers and directors. The top ten settlements in 2008 totaled $17.7 billion version $1.8 billion in 2007.

In general, fiduciary litigation may be brought three ways:

- As class actions by participants
- As individual claims by participants
- As government lawsuits by the Internal Revenue Service or Department of Labor

The most common basis for these claims center on two key issues: 1) the prudence of selecting or holding a particular asset (typically the employer’s stock), and 2) the selection or performance of service providers. Claimants may assert, for example, that the employer’s stock should never have been selected in the first place or that sponsors failed to divest the stock when they knew it would perform poorly. They might also assert that service providers underperformed, charged excessive fees or failed to fully consider or comprehend investment choices.

**COMPLEX CHOICES**

Understanding investment choices is in fact at the core of what makes investment management complex. Take the following situation:

A plan needs to rebalance its portfolio and shift assets from its MSCI EAFE manager. However, the securities are out on loan to a broker/dealer. What are the risks? The costs? Are there alternatives to rebalancing?
While the answer might be obvious to a genuine expert, it could be daunting to a director or CFO. From the legal structure of the securities lending relationship (between the plan sponsor, investment manager, custodian and prime broker) to the liquidity constraints surrounding short-term collateral pools – a director or CFO can be on very shaky ground when analyzing these issues. In such situations, the tendency is often not to do anything. That is why many sponsors are taking an almost “deer in the headlights” approach to investment decisions. Inaction of course can invite the very outcomes sponsors wish to avoid – underperformance and potential lawsuits.

To get an abbreviated glimpse of what investment fiduciaries face (whether they appreciate it or not), take a look at Table 4. Sponsors have their choice of strategic allocations and an array of options over which to allocate investment assets – involving different types (and roles) of investment consultants, asset classes and philosophies. The permutations form a veritable Rubik’s Cube of possible scenarios. How, for example, should they allocate across bonds, cash, real estate, currency and other asset classes? Should they use hedge funds? Do they want to be more quantitative or fundamental? What’s the appropriate mix of core-to-value-to growth of equities as determined either by market cap or trading style? What’s their exposure to emerging or developed markets by asset class, investment style and industry sector? And most importantly, what are the most appropriate solutions given the specific features of each unique plan and company?

There may be more than one “right” answer, of course. It all depends on a host of variables including the plan’s risk profile, performance goals, ERISA requirements, the state of various financial markets and countless other factors.

**TABLE 4: A RETIREMENT PLAN SPONSOR’S INVESTMENT MANAGEMENT LANDSCAPE**
Success lies less in having a particular answer than in having the knowledge on both the legal and investment management sides to consistently analyze and fully exploit available opportunities without taking imprudent risks.

A UNIQUE SYNERGY

This synergy of legal and investment management expertise is obviously key to making the model HFG proposes work. Two essential ingredients would seem obvious: 1) that the principals demonstrate deep knowledge over many years in their respective fields of ERISA and investment management, and 2) that they’ve proved they can work well as an integrated team.

Admittedly, given those two criteria, such a synergy will be extremely hard for any would-be HFG competitor to replicate. From a business standpoint that may be good for HFG, but it is also good for those fortunate enough to be HFG’s clients.

The backgrounds of HFG’s professionals, Mitchell Shames, Dave Nolan, Barbara Shegog and Jane Tisdale, are on the firm’s website – and need not be repeated in detail here. The key takeaway is their combined 75+ years experience and specifically their professional roots at State Street Global Advisors, and its predecessor, as key contributors to building SSgA into the world’s largest pension plan investment manager, with over $2 trillion under management.

Though rare, such a combination is exactly what corporate sponsors of ERISA-qualified retirement plans need if they hope to get out from under the ever-increasing weight of sponsorship – and get back to running their companies full time. The last thing sponsors need is another manager to manage. That’s why HFG proposes a new model of corporate retirement plan sponsorship. It offers hope to directors and officers seeking to regain their agility in a challenging business environment.

Fees

Hiring an outside firm as a named fiduciary raises the question of how that firm should be compensated. HFG believes the correct model is a flat fee based upon three key factors:

- The fiduciary risks the firm assumes
- The engagement’s complexity
- The professional expertise rendered

The fee should not be a basis point charge tied to either “assets under management” or investment returns.

In HFG’S case, the flat fee structure goes to the core of the business model proposed here and reflects HFG’s own corporate values. Plain and simple, the assets held by a plan belong to the plan’s participants and beneficiaries. Service providers, and in particular fiduciaries, should not have a “call” on the upside investment performance of plan assets. We believe managers of hedge funds, private equity, venture capital and real estate funds, as well as many long-only managers have grown too accustomed to sharing on the upside in the form of performance and asset based fees, without sharing any of the risk on the downside.

HFG rejects the widespread acceptance of this “heads I win, tails you loose” staple of the investment management industry. We challenge other fiduciaries to do the same.