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MANAGING THE UNIQUE CHALLENGES OF COLLEGE AND UNIVERSITY RETIREMENT PLANS

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Andrew Bayliss
Vice President, Marsh & McLennan Agency

Ann Longmore
Managing Director, Marsh

Marsh & McLennan Agency
www.MMA-NE.com
Marsh
www.Marsh.com

Agenda

I. Fee Litigation Trend

II. Managing Your Fiduciary Responsibility

III. Fiduciary Liability Insurance

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FEE LITIGATION TREND

Fee Litigation Trend
May 2017

The litigious trend facing colleges and universities intensified in May, as more schools were faced with lawsuits pertaining to their retirement plans.

1. **University of Chicago**
   Filed on 5/18/17, allegations include high fees and a failure by plan fiduciaries to monitor investments.

2. **Princeton University**
   Filed on 5/25/17, allegations include a failure to negotiate lower plan fees, choosing high fee investment options and overpaying for recordkeeping by having multiple investors.

3. **Emory University**
   Originally filed in August 2016, Emory's motion to dismiss their plan-related lawsuit was dismissed in US District Court.

Allegations include too many funds, failure to monitor funds "required by the recordkeeper", and failing to choose one recordkeeper.

Fee Litigation Trend
A Growing Problem

The University of Chicago and Princeton join a growing number of schools facing class action lawsuits over their 403(b) plan.

Fee Litigation Trend
Its Not Just a University Problem

Beginning in 2016, lawsuits targeting colleges & universities became the latest chapter in a series of cases brought against retirement plan fiduciaries for neglect:

- 401(k) plan sponsors like Boeing, Lockheed Martin, ABB and Anthem have faced lawsuits regarding high fees, poor investment performance & other fiduciary failures.
- Plan providers such as Fidelity & TIAA-CREF have also faced allegations of high fees and self-dealing.

403(b) Plans the New Target

Until recently, non-profit organizations, including educational organizations, were not subject to ERISA.

- Many 403(b) plan sponsors still lack the fiduciary oversight framework used by many 401(k) committees.
- These new cases will test the essential structure of such plans and determine whether fiduciary standards developing in the 401(k) world should be applied in the 403(b) context.

Fee Litigation Trend
Theme of Allegations

The allegations in these lawsuits vary, but focus on the same key deficiencies:

- Fees are/were excessive and beyond what can be considered reasonable.
- Investments used retail share classes, not institutional.
- The plans used and retained investments that consistently underperformed their benchmarks.
- Investment menus offered “dizzying arrays” of options, sometimes exceeding 100 options in total.
- The use of multiple recordkeepers caused duplicative and unreasonable fees.
- Fiduciaries failed to properly analyze funds “required” by the recordkeepers.
- Plan Sponsors failed in their roles as fiduciaries to monitor and make decisions in accordance with ERISA.

MANAGING YOUR FIDUCIARY RESPONSIBILITY

Managing Your Fiduciary Responsibility
How Do You Become a Fiduciary?

Basics on Being a Retirement Plan Fiduciary

- There are two ways to become a fiduciary:
  1. Fiduciary by Title
  2. Fiduciary by Act
- Fiduciaries must adhere to Prudent Person, Exclusive Benefit, Investment Diversification & Plan Document Rules
- You can be held accountable for your actions
  - Ignorance of the law will not provide a defense
  - Civil and criminal penalties can be assessed
  - More and more plan sponsors are being held accountable via class action lawsuits.

Managing Your Fiduciary Responsibility
Bonds & Insurance

ERISA (Fidelity) Bond

- Every plan is required to be bonded.
- Bond requirement is 10% of plan assets, up to a $500,000 maximum ($1,000,000 if employer securities is offered).
- The cost of the bond may be paid from forfeiture or ERISA budget accounts.

Fiduciary Liability Insurance

- Not legally required.
- Covers losses and attorneys fees as a result of claims of breach of fiduciary duty.
- Covered parties include the Plan, Plan Sponsor, and individual fiduciaries.
- Do NOT assume coverage under E&O or D&O insurance policies.

Managing Your Fiduciary Responsibility
ERISA Section 404(c)

- Under § 404(c), plan fiduciaries will not be held responsible for any losses resulting from participants' direction of investment of assets in their account.

- To take advantage of § 404(c), the plan must satisfy certain operational and disclosure requirements. The basic requirements are:

1. The plan must offer a "broad range" of investment options (at least three) with materially different risk and return profiles.

2. Participants must be able to change investments with a frequency appropriate in light of the volatility of the investments.

3. Participants must be provided certain specific information intended to permit them "to make informed decisions." Some of this information has to be provided automatically, and some only at the request of the participant.

Managing Your Fiduciary Responsibility
Retirement Plan Committee

- Establish a plan committee to promote procedural prudence
- Establish operating procedures to create a concrete framework for fiduciary decision-making.
- The committee's responsibility is not to carry out the day-to-day tasks, but rather manage the process:
  - Hold regular meetings with a pre-set agenda
  - Review activities
  - Receive/give information
  - Monitor performance of advisors
  - Make and document decisions
  - Delegate implementation of decisions

Best Practice: Formalize the Committee with a charter (if consistent with your organization's culture)

Managing Your Fiduciary Responsibility
Annual Responsibilities

Investment Philosophy & Governance

- Maintain an investment menu that is prudent for your employee population and offers adequate diversification
- Follow ERISA “Prudent Man Rule” to establish suitable options
- Annually review your Investment Policy Statement
- Establish and execute policies and procedures for a proper investment review process (IPS)
- Facilitate investment decision-making process and document changes

Vendor Management

- Monitor service delivery and participant experience
- Assess and benchmark fees
- Periodically conduct request for proposal/due diligence

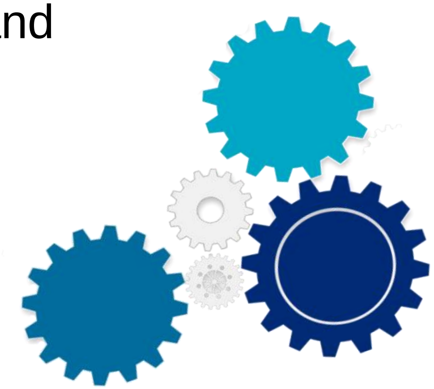
Managing Your Fiduciary Responsibility
Annual Responsibilities (Cont.)

Employee Engagement

- Encourage and support participation
- Continually enhance employee knowledge through education opportunities
- Maximize salary deferral rates and plan usage
- Help employees set goals and objectives

Plan Cost Analysis & Benchmarking

- Review participant and investment fees for transparency and competitiveness
- Benchmark fees with market and industry averages for your plan's size
- Facilitate distribution of participant fee disclosure statements



The Purpose of the Investment Policy Statement

- Clarify the plan's investment-related goals and objectives
- Provides an objective framework and baseline for evaluating investments
- Creates continuity in decision making as plan fiduciaries change
- Protects the Committee from inadvertently making capricious or arbitrary decisions
- Helps manage pressure for change generated by participants, vendors or the media

Performance versus Process

- While strong relative performance is desired; it is not the ultimate goal of the Investment Policy Statement
- A comprehensive, consistent and repeatable process is required of fiduciaries with the expectation that performance is the result

Managing Your Fiduciary Responsibility
IPS Screening Criteria

Your Investment Policy Statement (IPS) should list the criteria used to measure and screen the Plan's investment options. This criteria can include both quantitative and qualitative measurements.

Quantitative Criteria

- Performance across various time frames
- Risk-Based metrics such as Alpha, Sharpe Ratio, etc.
- Fees/ Fund's expense ratio

Qualitative Criteria

- Adherence to prospectus' stated philosophy
- Fund Manager and/or analyst turnover
- Change in fee structure
- Any update or change to be deemed as negative or not in line with the Committee's philosophies

Plan Cost Analysis & Benchmarking

The Department of Labor regulations under ERISA and specifically, 408(b)(2) require that all fees be "reasonable" for services being provided.

It is incumbent upon each fiduciary and retirement plan decision maker to thoroughly review and more importantly understand all fees associated with the retirement plan.

Your responsibility:

1. Understand cost(s) and how they are derived
2. Determine the reasonableness of the fees.

FIDUCIARY LIABILITY INSURANCE

Background Noise
What Does This All Amount To?

- A study found that an average family may end up having *30% less* in total lifetime accumulated savings in their 401(k) plans – or 403(b) plans - due to higher than necessary fees and expenses
- “Revenue sharing" arrangements and a potential lack of transparency, have lead to litigation
  - Over the past decade, +75 lawsuits have been brought alleging “excessive fees” in defined contribution retirement plans.
  - While these initially focused on large, company-sponsored defined contribution plans, they have since expanded to sponsors of smaller plans and even non-profits.
    - In most cases, these excessive fee lawsuits can be broken down into three categories – one of which is dubbed the “university cases.”

*An AARP study found that more than 80% of plan participants were **unaware** of how much they were paying in fees associated with their retirement savings plan.*

Selecting Investment Options
A Continuing Exercise in Fiduciary Responsibility

- Selecting an investment or service provider is, in and of itself, a fiduciary decision that is subject to the fiduciary standards under ERISA

- There is then *a continuous duty* to monitor these providers,
  - Part of selecting and monitoring the performance of a service provider is in considering the related fees
    - As a best practice, these may be compared against industry benchmarks along with investment performance/services rendered
    - Due to the need for continuous monitoring, it is best if these comparisons are done on a regular basis.

Best Practice: Critically, these fee and service reviews need to be documented, demonstrating a thoughtful process, the discussions and decisions made; when revisions/changes are needed they need to be made (changing out options or service providers).

Management Liability Insurance: Fiduciary Liability Coverage
The "Who"

Most colleges/universities will either purchase a not-for-profit or private-company management liability policy with a Fiduciary Liability coverage part – or ***standalone*** Fiduciary Liability coverage

- In both cases, Fiduciary Liability insurance usually broadly covers the plan sponsor, the plans it sponsors* for its employees (pension and welfare benefit) and in-house plan fiduciaries and administrators
  – Some policies expressly add coverage for related pension committees, which may have been responsible for selecting/negotiating plan investment options [potential defendants in fee litigation]

Practice Tip: I have seen some insurers deny coverage for a claim when the plan was never included on the application for Fiduciary Liability insurance.

Fiduciary liability coverage
The "How"

Coverage is triggered by a "claim" and typically these is broadly defined as:

> "*any written allegation of a wrongful act seeking damages covered by this policy*…"

Takeaway: this is **<u>not</u>** limited to formal law suits, but could include email or notes from plan participants, for example, complaining about an issue and seeking a resolution

Hidden risk: Upon receiving a "claim" it is the insureds' obligation to provide timely notice to the one's insurer(s)

If this duty is not be met, <u>coverage may be lost for this and for any related "claims."</u>

Fiduciary liability coverage part
The "What"

Fiduciary liability policies provide necessary defense and investigation costs related to Claims and covered settlements or court awards

Defense + Investigation

Trigged by allegations of breach of fiduciary duty or errors/omission in plan administration, defense costs are insured:

- After timely notice to the carrier of the claim (as soon as reasonable w/in the policy period)
- Once written approval has been received from the insurer
- *May be* subject to a "panel counsel" or preapproved law firms (and rates)

Settlements + Court Awards

- Generally including plaintiffs' legal costs, interest, etc.
- Does not include "benefits due"
  - But assets (or fees) are not benefits (some policies expressly state this).

QUESTIONS

Questions

Thank you for attending!
Should you have any questions, please contact:

Andrew Bayliss, AIF®, CPFA®
Vice President, Retirement Services
Tel: (617) 587-2342
Andrew.Bayliss@MarshMMA.com

Ann Longmore
Managing Director, Marsh
Tel: (212) 345-2123
Ann.Longmore@Marsh.com

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