

Raising the Bar

How to get new investment committee members up to speed

New investment committee members often get little guidance on how to do their job correctly, says Ron E. Hagan, CEO of Arlington, Texas-based Roland Criss, a consulting firm that advises fiduciary organizations. "The training gap is a very serious problem."

"The worst-case scenario is that they are just told, 'We have a benefits committee meeting next Thursday' and they are expected to come. Or they get a massive three-ring binder," says Catherine Gordon, a principal at Vanguard Institutional Advisory Services in Malvern, Pennsylvania. Asked about the biggest mistake sponsors make in bringing on new committee members, she says they often neglect to prepare them beforehand. "Do not have it just be on-the-job training," she says. "That can lead to a less-than-effective group. Spend time training them upfront. Make sure that people are not coming in cold."

Approaching prospective-client situations, Molewski Financial Partners finds some committees very loosely organized and others with more formalized setups, says Wes Schantz, a partner at the Bethlehem, Pennsylvania-based advisory firm. He recently visited one company with a three-person committee that meets once a year and neglects to work with an outside adviser, instead relying very heavily on its recordkeeper to keep the plan running properly. "Some committees, it would appear, have their heads in the sand," he says. "With fee-disclosure regulations and the litigation we have seen, it is not a time when you can ignore your responsibilities."

The majority of plans provide little or no fiduciary training to new or current committee members, says Rocco DiBruno, director of the Santa Fe, New Mexico-based Thornburg Retirement Group and author of the book "Best Practices for Investment Committees." These plans rely on their adviser or recordkeeper to make sure the plan is functioning and complying with fiduciary issues, he says. "I do not think that they understand the gravity of the situation and their responsibility."

Sources talked about three areas where new committee members most need education and what they should know:

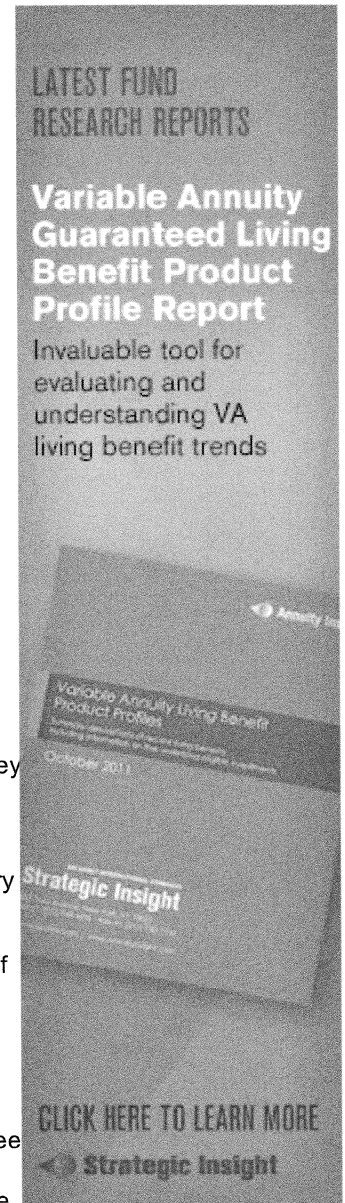
1) Grasping fiduciary principles. All too often, especially in small plans, sponsors believe that their plan provider serves as the fiduciary, Hagan says. "Plan sponsors cannot delegate away their fiduciary responsibility; they are the ones who are ultimately accountable."

New committee members also need to understand this principle. Senior Consultant Gina Gurgiolo, of Portland, Oregon-based Multnomah Group Inc., says that when she and her colleagues inform committee members of their fiduciary responsibilities, about three-quarters seem surprised.

And, according to Gordon: "They need to understand, number one, that the standard to which they are held as fiduciaries under ERISA [Employee Retirement Income Security Act] is very high and what it means to be a 'prudent expert.' And number two is to understand their personal liability as a committee member. I sometimes say to people, 'Do you like your house? Do you like your car?' For 99.9% of committees, it will never come to that. But it should be made clear that if there were to be an issue, the liability does not stop at the assets of the plan; it extends to the personal assets of people on the committee."

Gurgiolo and her colleagues meet with new committee members to review a fiduciary guide. The guide typically runs about 16 pages and includes a checklist aimed at ensuring members understand their fiduciary responsibility. If a plan falls under ERISA Section 404(c)—in which participants have the option of directing their investments—an additional checklist addresses issues relating to that, too. That meeting may run about 90 minutes.

Fi360 Inc. offers as an option a basic fiduciary course that can take more than 20 hours to complete. But most investment committee members want shorter training, says Rich Lynch, chief operating



officer of the Bridgeville, Pennsylvania-based training and resource provider for investment fiduciaries. "Four hours, in our experience, is probably about right for training that you might get committee members to go to," he says.

The best approach, experts say, is to concentrate on a few fundamentals. "You can get into a lot of minute detail with ERISA," says Scott Gehman, a benefit consultant at Conrad Siegel Actuaries in Harrisburg, Pennsylvania. "For the committee, it is most important to understand their responsibility, and it is really pretty simple. They need to act in the sole best interests of plan participants and beneficiaries. And they need to act in the capacity of a prudent expert or hire somebody who can." Those foundations apply to tasks such as choosing appropriate, diversified plan investments, as well as understanding the true costs of a plan and ensuring that those costs are appropriate, he says.

Gurgiolo recommends that new committee members understand at least four guiding ERISA principles. First, the members have a fiduciary responsibility for ongoing monitoring of plan providers. Second, they must always follow plan documents—without exception. Third, they have to ensure that the plan includes properly diversified investments. And fourth, they must make sure that the fees the plan and/or its participants pay are reasonable for the services received.

Several sources interviewed for this article recommend that as fiduciary training ends, new committee members be asked to sign a fiduciary-acknowledgment letter. "The reaction often is fairly strong," says Lynch. "People may say, 'Wait a second, why do I need to sign something?' We say, 'You are in a fiduciary role, and it is important that you understand that.' It leads to a serious discussion of what their role is and what they need to be thinking about." And usually it also leads to discussing how the employer protects people willing to take on this role, such as with liability insurance.

Schantz also recommends that people sign that fiduciary acknowledgment upfront. "We have had people selected as potential committee members bow out" when asked to sign, he says. "It may sound cool to be selected, but, at the end of the day, it is a big responsibility."

It is better to discover a committee member's reluctance sooner rather than later, Lynch says. "As important as their experience is, is this something that they really want to do?" Acknowledging fiduciary status in writing, he says, "brings to light who really wants to do it—and who does not but is doing it [merely] because he thinks he should."

2) Understanding investment strategy. "Investment committees in general spend way too much time on [investment minutiae]. It is fun to talk about this investment or that investment. Everybody likes to play 'investment expert,'" Lynch says. A committee likely has hired an investment expert to give it recommendations, he says, so it makes little sense to get absorbed with small details. "You probably are not going to be able to add more than what a professional has done," he notes.

Exactly how much investment expertise new members should bring to the table varies. "It would depend on the other committee members and where they fit into that mix," says Jeb Graham, partner and retirement plan consultant at Tampa, Florida-based CapTrust Advisors LLC. For instance, a plan may replace a human resource manager rotating off the committee, while the chief financial officer (CFO), director of benefits and vice president of human resources remain. "So the expectation of what that new person will need to know, and that person's acumen on investments, will be lower than if the committee replaced the CFO as a member," he says.

However, every new member needs to study the investment policy statement (IPS), and Lynch cites it as the single most important document to read beforehand. "The IPS is essentially the business plan that lays out how you are going to manage assets," he says. "A lot of it is fairly straightforward, but highlight the areas that do not make any sense to you, and ask somebody to explain them."

People should focus on understanding the portfolio or investment lineup's strategy. "You are not a portfolio manager, so to spend time at committee meetings debating why a manager bought Exxon Mobil instead of Shell is not productive," says Gordon. "It is much more about understanding investment strategy, as opposed to every single nut and bolt. It is really important to have a good understanding of why the investments look the way they do." If a plan has gone heavily into passive investing, for instance, a committee member should understand why.

New members also should have a good grasp of how the portfolio or investment lineup works overall, DiBruno says. That means understanding if a plan has the right mix of equity and fixed-income or domestic and international investments. "You need to have balance," he says. "An investment committee needs to be educated on asset allocation and the importance of how the funds work together in terms of correlation. More than anything, it is about managing risk."

3) Learning prudent processes. When Graham talks to new committee members, he emphasizes the importance of striving to achieve governance best practices. "At the macro level, committee members

understand that if they thoughtfully lay out a process and follow it, and always think of what is going to be most favorable for participants, they are going to be OK," he says.

Many committees avoid the legwork involved in monitoring investments by working in tandem with outside experts. "ERISA requires that if you cannot act as a prudent expert, you basically have to bring in someone who can," Gehman says. "Some of the most successful committees I have worked with as an investment consultant have been committees where our firm brings the investment knowledge and they bring the knowledge of their organization and employees."

"Advisers come to the table with the metrics," says DiBruno "[Committee members] need to be educated in what that means and whether the investments meet the investment policy statement."

To help them work well with the adviser on monitoring, Graham talks to new committee members about basic investment terminology and concepts. "The objective is to give them an understanding of what we will be talking about in the reports," he says. This can include explaining the difference between small-cap and large-cap equity; the meaning of basic risk measures, such as standard deviation; and what different fixed-income investment grades indicate. "So, then, when we go in and say, 'This one is on a watch list,' they can understand at some level," he says. "And when we make a recommendation and they are in line to approve the recommendation, they can know that the documentation process is valid and they can act intelligently on behalf of participants."

Committees also often work with an outside expert on the fee-monitoring process. New fee-disclosure rules emphasize the importance of verifying fees' reasonableness, says Hagan, but many sponsors have no experience with this and, therefore, are unsure how to proceed.

Committee members need to understand such basics as the expense ratio and how much a fund manager keeps versus how much goes to offset recordkeeping and administration. "It is important to have a sense of revenue sharing," says Graham. Committee members also need to be able to decide when they should take action—for example, whether benchmarking data showing that a plan has higher fees than its peer group merits looking into other investment options.

New committee members should also have a basic understanding of how to effectively monitor a provider. When reviewing the history of the U.S. Department of Labor (DOL) in bringing action against plan sponsors, Hagan says, two process-related issues crop up with incredible regularity. While automation has made one of them—timely transfer of money from payroll accounts to investment accounts—less of a challenge, the failure to prudently select and monitor service providers remains a major concern. "When plan sponsors put all their eggs in the recordkeeper basket, they have dug themselves a huge hole and they are waiting to be pushed into it," he says.

Again, many get help from a consultant or adviser. "At some level, a committee will have its own sense of what good services are not. But they may be unable to measure what [good services are]. That is where we come in," Graham says. "It is done in the context of looking at their fees. Really, just evaluating fees is not that useful if they are not looking at the services."

While committee members need not understand how to do CapTrust's service analysis step-by-step, Graham says, it helps if they understand it conceptually. "We always tell them that they are in charge of overseeing our service, as well," he says. "When you hire a 3(21) fiduciary like us, the client does not get rid of the liability, but the liability shifts to 'Did you do the appropriate due diligence in hiring an RIA [registered investment adviser]?'"

