



MINIMIZING RISK AND MAXIMIZING OUTCOMES

BASIC REQUIREMENTS AND BEST PRACTICES FOR TODAY'S PLAN SPONSORS

APRIL 2010

The emerging retirement agenda in Washington seeks to expand retirement plan participation, promote transparency and enhance benefit security.

While these efforts by policymakers are essential, plan sponsors must also play an active role—both in meeting new fiduciary and compliance requirements, and in producing better outcomes for their participants through an optimized plan design. Employees, too, must do their part by participating, saving diligently, maintaining a properly diversified investment portfolio and developing a retirement income strategy.

The first step for plan sponsors is to ensure that the plan complies with the new 403(b) regulations. A recent study of plan sponsors by the TIAA-CREF Institute found that while nearly three-quarters (74%) of respondents believe they are fully compliant, almost half (45%) say they have difficulty even understanding the regulations.¹ Once plan sponsors have a good understanding of the regulations, it's important to reevaluate their plan design.

This paper provides guidance to help plan sponsors understand their role as a fiduciary, highlights strategies to minimize fiduciary and compliance risk, and discusses the resources and services that a provider such as TIAA-CREF can offer to help them, along with any advisors they may have, ensure that their employees enjoy lifetime financial security.

WHAT'S A PLAN SPONSOR TO DO?

In today's rapidly changing regulatory environment, the risks of failing to operate retirement plans in a compliant manner have increased.

To help plan sponsors fulfill their fiduciary obligations and maximize participant outcomes, this paper highlights three critical steps:

1. Know and understand fiduciary and compliance requirements
2. Adopt best practices to minimize fiduciary and compliance risk
3. Seek guidance from plan providers and use all available resources



FINANCIAL SERVICES
FOR THE GREATER GOOD®

¹ David P. Richardson, Principal Research Fellow, TIAA-CREF Institute, and Paul Gallagher, Managing Director, TIAA-CREF. *Are Plan Administrators Prepared to Meet the New Regulatory Requirements?* January 2010.

STEP 1

MINIMIZING RISK: UNDERSTAND BASIC REQUIREMENTS

Fiduciary responsibilities for plan sponsors are detailed in the Employee Retirement Income Security Act (ERISA) of 1974, which is enforced by the Department of Labor (DOL). Although some plans may not be subject to ERISA's fiduciary requirements, it is widely recognized that satisfying those requirements—even for a non-ERISA plan—is a recommended practice. And while not every plan **must** follow ERISA guidelines, all plans must comply with IRS regulations. The following overview summarizes key fiduciary and compliance roles and responsibilities. Plan sponsors should consult with their service providers, legal counsel or other advisors for detailed guidance.

FIDUCIARY RESPONSIBILITIES

Who is a plan fiduciary?

Whether formally designated a fiduciary or considered one by virtue of the role or activities performed, a fiduciary is responsible and liable for some or all aspects of plan operation.

- A “named fiduciary” is one specifically named or designated in the plan document, trust agreement or by a designation procedure spelled out in the plan document.
- Under ERISA, anyone who engages in any of the following is also considered a fiduciary:
 - Exercises any discretionary authority or control over management of the plan or the management of plan assets
 - Renders investment advice for a fee or other compensation (direct or indirect) or has any authority or responsibility to do so
 - Has any discretionary authority or responsibility in the administration of the plan

What are the fiduciary's primary responsibilities?

A fiduciary of an ERISA plan must meet certain standards in five key areas:

- **“Exclusive Benefit” rule.** Fiduciary obligations must be performed solely in the interests of plan participants and beneficiaries.
- **Compliance with terms of the plan documents.** Fiduciaries must act in accordance with the terms of the plan document at all times.
- **Diversification of plan investments.** ERISA generally requires the fiduciary to diversify plan investments to minimize the risk of loss.
- **Selection of service providers.** A fiduciary must exercise prudence in selecting and monitoring service providers for the plan.
- **“Prudent Person” standard.** A fiduciary must act with the care, skill, prudence and diligence that a prudent person in a similar capacity would use under like circumstances.

What are the penalties for noncompliance?

Failure to meet fiduciary obligations can result in serious penalties and liabilities, such as:

- **Personal liability.** A fiduciary can be held personally liable for any losses to the plan resulting from a breach of fiduciary duty.
- **Legal action.** The DOL, a participant, a beneficiary or another fiduciary can bring a civil claim against the plan fiduciary.
- **Fines.** For a fiduciary breach resulting in a financial loss, the DOL can assess a 20% penalty on the amount of the loss. If the breach involves a prohibited transaction, excise taxes may also be levied.

COMPLIANCE RESPONSIBILITIES

Who is responsible for ensuring compliance?

When it comes to compliance, clarity of roles is essential. While organizational structures vary, all plan sponsors should clearly designate—and document—who is responsible and accountable for each aspect of plan compliance.

What are the plan sponsor's primary compliance requirements?

New IRS regulations that took effect in 2009 essentially transform 403(b) plans from primarily employee-controlled, tax-sheltered accounts into fully integrated plans in which the plan sponsor bears responsibility and liability for a broad range of factors. Among the key compliance areas addressed by these changes are:

- **Plan documentation.** All 403(b) plan sponsors are now required to maintain a written plan document that includes detailed information on plan eligibility, benefits, contribution limits and distributions.
- **Operations.** Employer-funded 403(b) plans must satisfy statutory universal availability and nondiscrimination requirements, including new control group rules. These requirements are designed to ensure access to the plan for all eligible employees and equitable distribution of plan benefits among highly paid and non-highly paid participants.
- **Transactions.** Participant-directed asset transfers are generally limited to authorized fund providers that share information with the plan sponsor. Transaction monitoring helps the plan sponsor ensure employee contributions and distributions comply with IRS rules.
- **Financial reporting.** ERISA 403(b) plans are now subject to the same Form 5500 (Annual Return/Report of Employee Benefit Plan) filing requirements as 401(a), 401(k) plans and private-sector defined benefit plans. In addition, large 403(b) plans—those with more than 100 eligible participants at the beginning of the plan year—are generally required to have their financial statements audited by an independent auditor beginning with the 2009 plan year.

What are the penalties for noncompliance?

Noncompliance can lead to a range of penalties for both the plan sponsor and individual participants, depending on the severity and scope of the issue. These penalties may include:

- **Fines** levied against the plan sponsor
- **Tax liability** and penalties for individual participants if plan contributions or distributions exceed IRS limits or otherwise fail to comply with appropriate regulations
- **Full plan disqualification**, which could make all plan assets subject to taxation

STEP 2

MAXIMIZING OUTCOMES: ADOPT BEST PRACTICES

“Best practices” aren’t simply a loose collection of administrative tasks but rather a cohesive set of policies and processes that support an overarching goal: **Reducing risk for plan sponsors while increasing the likelihood of successful outcomes for participants.** The most effective way to optimize fiduciary performance is through a strategic approach encompassing all aspects of plan design, governance and oversight. The steps outlined below can help plan sponsors ensure fiduciary and regulatory compliance.

▶ ESTABLISH A PLAN GOVERNANCE PROCESS

- Create written plan governance policies that define all fiduciary roles, protocols and procedures.
- Ensure that all individuals designated as fiduciaries within the organization are aware of their status and receive proper training to understand their duties and potential liability for not meeting those duties.
- Consider forming committees tasked with key areas of responsibility, including an investment committee to oversee investment selection and review.

▶ REVIEW AND UPDATE PLAN DOCUMENTATION REGULARLY

- Review and update the plan document. Since both ERISA and the IRS require a written plan document, it’s helpful to establish a disciplined process that spells out how the written document will be created, maintained and updated. Review all plan documents with legal counsel.
- Create an investment policy statement that spells out guidelines for selecting and monitoring plan menu options and service providers. The policy statement must align with the plan’s objectives.

▶ REVISIT PLAN DESIGN TO PROMOTE BETTER OUTCOMES

- Expand plan coverage for all eligible employees, supported by automatic enrollment. Adopt a qualified default investment alternative (QDIA) to enhance the asset allocation options for new participants who fail to provide instructions on how their contributions are to be invested.
- Increase overall benefit security and savings levels through the use of an automatic annual increase program. Consider offering catch-up contributions for participants over age 50 to help pre-retirees maximize their savings.
- Consider a three-tiered investment lineup that not only ensures broad diversification to help balance risk and return for all investor types, but also offers guaranteed retirement income solutions. Each tier meets different investor needs:
 - **Tier 1:** Target-date options—a one-stop choice for participants who are hesitant about making investment decisions or simply prefer to have their retirement assets managed professionally.
 - **Tier 2:** Mutual fund lineup—with 15-20 investment vehicles for flexible asset allocation without an overwhelming number of choices.
 - **Tier 3:** Lifetime income—guaranteed income for life to help meet basic needs in retirement.
- Offer comprehensive employee financial education and wellness programs, including objective, noncommissioned investment advice.
- Provide opportunities to save for retiree health care expenses.

▶ MONITOR PLAN TRANSACTIONS AND INVESTMENTS

- Establish a process to ensure that contributions, distributions and other participant transactions meet their respective limits and sequencing requirements. Plans served by multiple vendors are required to establish a process for monitoring participant transactions such as loans and hardship withdrawals across vendors.
- Monitor investment performance against established benchmarks.

▶ COMMUNICATE WITH PARTICIPATING EMPLOYEES REGULARLY

- Implement a process for notifying employees, as required, about plan eligibility, enrollment deadlines, contribution limits, QDIAs and other information.
- Educate employees to help them understand the benefits of plan participation, build their knowledge of investments and take appropriate action to keep their retirement savings on track.
- Partner with provider(s) to ensure employees receive objective advice that helps them make informed investment decisions.

▶ CONDUCT AN ANNUAL PLAN AND INVESTMENT REVIEW

While not required by regulation, we strongly advocate an annual plan and investment review. These reviews can help clarify how well the plan is working and identify areas for improvement. Reviews should cover areas such as plan participation, asset flows, service quality, cost, transaction activity, participant satisfaction and investment performance.

▶ MAXIMIZE VALUE THROUGH PLAN SIMPLIFICATION

- Take steps to control costs, which may include consolidating multiple providers to a single provider offering greater control, flexibility and cost-efficiency.
- Evaluate each provider's ability to assist with administrative tasks, which can ease the burden on the plan sponsor's staff and help manage or reduce costs.

A STRATEGIC APPROACH TO ADOPTING BEST PRACTICES

- Raises awareness of the plan sponsor's fiduciary and compliance responsibilities and potential liability to all levels of leadership in the organization
- Establishes compliance as a top priority
- Reduces exposure and risk for plan fiduciaries

ENSURING LIFETIME INCOME FOR EMPLOYEES

A well-diversified fund menu should include a three-tiered investment lineup that contains a variety of investment options, each with different objectives, benefits and suitability to serve a wide range of investor needs.

Most plans include investment vehicles that help employees accumulate assets during their working years. However, the steady decline of defined benefit (DB) plans, combined with the unprecedented stock market volatility of 2008 and 2009, has underscored the importance of providing guaranteed options, such as annuities, designed specifically to meet income needs through retirement.²

According to the 2010 Retirement Confidence Survey, 75% of workers report they will rely on employer-sponsored defined contribution (DC) plans for retirement income. With anemic stock market performance over the past several years—the S&P 500® Index, for example, produced average annual total returns of 0.42% and –0.95%, respectively, for the 5- and 10-year periods ended December 31, 2009³—many employees are seeking ways to protect their retirement savings from the volatility of the market. And nearly half (46%) say they are very or somewhat likely to choose a retirement plan option that pays them monthly guaranteed income for life.⁴

Guaranteed options such as annuities that are designed specifically to meet retirement income needs are not only an appropriate investment vehicle for the third tier in a three-tiered investment lineup, but given the current retirement landscape, they are also the most effective way to provide retirees with a steady stream of income that they can't outlive. Of course, no single fund or investment vehicle represents a complete retirement savings program. But as a component of a diversified portfolio that may also include variable investments, a guaranteed annuity can play an important role.

Fiduciaries should practice sound due diligence when evaluating all investment tiers and options, including guaranteed annuities. By using a prudent, carefully documented process to demonstrate how and why each investment is a good fit for the overall plan—and in the best long-term interests of participants—plan sponsors can be confident that their lineup is consistent with their fiduciary obligations.

² Guarantees are subject to the claims-paying ability of the issuer.

³ S&P 500 is a registered trademark and a service mark of the McGraw-Hill Companies, Inc.

⁴ Employee Benefits Research Institute; 2010 Retirement Confidence Survey
<http://ebri.com/pdf/PR.868.9Mar10.RCS-10.Final.pdf>

STEP 3

SEEK GUIDANCE AND RESOURCES

Backed by years of experience as a leading 403(b) plan provider, TIAA-CREF has the knowledge and insight to partner effectively with many different types of institutions and other advisors that serve them. To help plan sponsors better understand their fiduciary and compliance obligations—and to make it easier to fulfill them—we offer a full suite of education, services and tools:

- **Fiduciary education**, including communication and training for administrators through consultation, access to subject matter experts, a comprehensive guide, checklist and other educational support
- **Plan document services** for creating, modifying or updating plan documents and remaining compliant with IRS and Department of Labor regulations
- **Investment consulting** to develop investment policy guidelines, assist with investment menu design and conduct annual investment reviews
- **Compliance monitoring services** to help minimize risk and ensure plan compliance in such areas as loan and hardship withdrawals, contribution limits, nondiscrimination and universal availability
- **Employee education and advice** for participants through a broad range of convenient programs including individual objective counseling and advice, seminars, publications and online tools and resources
- **Plan review and financial reporting services**, including annual plan reviews and full support for audit requirements associated with Form 5500 financial reporting

These resources are an important part of our commitment to provide plan sponsors and their employees with the best overall value for all their retirement planning needs.

BUILDING A HOLISTIC RETIREMENT SYSTEM

The economic turmoil of the past few years has taken a toll on retirement security for many American workers. As individuals look to rebuild their nest eggs, it has become increasingly important for policymakers, service providers, employees and employers to play an active role in strengthening the retirement system. Together these stakeholders can help ensure that the private retirement system is sound for future generations.

As Washington continues to focus on expanding retirement plan coverage for all workers, increasing benefit security and greater transparency, we urge all plan sponsors to do their part—by meeting current fiduciary and compliance requirements, and by reevaluating their plans to ensure that they are designed in such a way as to maximize employee outcomes.

As a service provider, TIAA-CREF is dedicated to helping ensure the financial security of those who work in the academic, medical, cultural and research fields. We will do our part to provide guidance and assistance to help plan sponsors meet their fiduciary and compliance obligations, offering plan design solutions with proven results and providing access to objective advice and guidance for employees.



**FINANCIAL SERVICES
FOR THE GREATER GOOD®**

You should consider the investment objectives, risks, charges and expenses carefully before investing. Please call 877 518-9161 or visit tiaa-cref.org for a current prospectus that contains this and other information. Please read the prospectus carefully before investing.

TIAA-CREF Individual & Institutional Services, LLC and Teachers Personal Investors Services, Inc., members FINRA, distribute securities products. Annuity contracts and certificates are issued by Teachers Insurance and Annuity Association (TIAA) and College Retirement Equities Fund (CREF), New York, NY.

©2010 Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF), New York, NY 10017