*Please note: This is a transcription so there may be slight grammatical errors.*

Trudy:

Hello everyone and welcome to today's webinar, Fiduciary Training. I would now like to introduce Dawn McPherson, director of Retirement Plan Consulting at CAPTRUST.

Dawn McPherson:

Thank you, Trudy. So we're really glad you're here today. Pleased to bring you this third installment in our new quarterly series, and I'm happy to have the opportunity to introduce you to our speakers today. I'll share a little of their background, but also some fun personal information so you can get to know them a little bit. Joshua Sutin is an ERISA attorney with Chamberlain, Hrdlicka law firm out of San Antonio, Texas. Joshua has been practicing law for almost 30 years by my calculations, and specializes in ERISA matters. He said this best actually, he helps smart people unravel complicated compliance matters surrounding employee benefit plans, and he does it while hoping to share some laughs along the way. So I liked that. He's been married 21 years and has four children. He loves to snow ski, but you could imagine that presents a little bit of a challenge living in Texas.

So he's opted for learning how to play tennis and pickle ball without suffering a heat stroke. Joshua, thanks for joining us today. Catherine Ellis is a CAPTRUST institutional advisor out of Austin, Texas. We didn't plan that, but it works out that we have two from Texas. You'll likely hear us refer to her as Cat throughout today's presentation, and she's been in the industry for 17 years. Cat actually grew up in Kansas City, which is where I'm based, and she moved to Austin, Texas in 2015. Funny enough, the following year, the Kansas City Chiefs, the Kansas City Royals and the Kansas University basketball team were all ranked number one and have since all won championships. So Cat's father has forbidden her from moving back to Kansas City.

Cat and her family also have a small homestead, which I find fascinating. She has chickens, goats, a miniature donkey and a barn cat. So it's always fun to hear her homestead stories. And last but not least, we have Kevin Fieldman on the line. He's a director and investment strategist with CAPTRUST. Kevin's based in Chicago, Illinois. And I learned that he's spent his entire life in Chicago, Illinois. Kevin's been in the industry for 30 years and he's been with CAPTRUST for eight of those years. And a few fun personal tidbits about Kevin, in addition to living in Chicago his entire life, he's been married for 28 years and has three adult children.

And my personal favorite is that at the age of 10 years old, he was a contestant on Bozo's Circus. So we've had a Jeopardy contestant on as a speaker, now we have a Bozo's Circus contestant on. As you can tell, we have a very season tenured group here to speak to you today. I am excited to hear their thoughts on retirement plan investment menus. Thanks to each of you for joining us and to our speakers. And with that, Joshua, I'm going to kick it over to you to get us started today and just talk about the overarching fiduciary responsibilities around retirement plan investment menus.

Joshua Sutin:

Thank you, Dawn, very much, and thank you everyone. Why I was excited to do this with CAPTRUST is I don't sleep well at night because I'm always worrying about my clients who sponsor qualified plans and are subject to ERISA. And it's because ERISA has fiduciary duties, what we're going to talk about today. But what I don't think people understand or where from an ERISA lawyer's perspective, the way I view it is I worry because if you are a fiduciary and you have fiduciary duties, that's the highest duty under law, which means you have a big red target on you with an F because plaintiff attorneys or the government can get to you pretty easily if you're not meeting those high duties. You have to show that you meet

these high duties all the time. And if a plaintiff's lawyer can show you're not meeting those duties, then it's pretty easy to show a breach.

And if they can show a breach of a duty, it's pretty easy under the law, to get to your personal pocketbook if you're a fiduciary. That breach, it goes through the corporate veil, pierces the corporate veil, and goes to the individual's pocketbook. So what scares me is that I have many clients who have individuals in their companies who are working with their qualified plans, and if they don't understand that they're a fiduciary, then they're probably not doing their duties. And if they're not doing their duties, we're all in a lot of hot water potentially. And that's my job, is to try to help people do their fiduciary duties so that if you do your duties well then you really have no worries. You'll have no liability if you really know your duties and you do them well. So I help people identify who the fiduciaries are under ERISA, what the duties are, and then how do we do processes and procedures to really document and show we are doing our duties, which is very important.

And that really should be done through your own processes and procedures, but with your vendors who can help you to do that and help you be experts in areas that you're probably not typically an expert. So that's what we're going to do here in the next few minutes is I'd like to help everybody understand who's a fiduciary and what those duties are, and then really turn it over to CAPTRUST to help us show the processes and procedures they do to help their clients who may be fiduciaries do their duties. So you'll see here the first slide we show is what I call the duty the fiduciary that most people don't realize. And that is a discretionary fiduciary. And this is anybody in our company who works with our qualified plan, who's making decisions around plan assets, investment decisions, where the assets are going, how assets get into the trust and come out. And if you are making decisions about the plan, for example, somebody appeals a claim and you deny that appeal, that's a fiduciary action. And by discretion, you become a fiduciary when you do those actions.

And a lot of people don't realize that if they serve on a committee that is choosing to the investments for the plan, those people are clearly fiduciaries and they may not quite realize it. So the other fiduciaries that people probably are more familiar with are if we pay somebody to provide us investment advice. So if we're on a committee or we're part of a plan that's choosing investments, we usually will go hire an outside investment advisor to give us advice. If we're paying them and they're giving us advice, they too will be a fiduciary. So on the next slide, we show you [inaudible] our other ways that people can be a fiduciary. So you see the very first one says named fiduciary. So under ERISA, if you're a trustee of a trust, which is on this list or you are a plan administrator, you are a named fiduciary and these are truly named in our documents.

So all of you please go back to your plan documents and find your trust document and look and see who is named as the trustee. They are a fiduciary. Also, go to your plan document and read where does it define plan administrator? The plan administrator is a named fiduciary, and if your named plan administrator is the board of directors of your company or the managers of your LLC, then we are creating a large pool of fiduciaries because now the whole board is named as the plan administrator. So really think about how are we going to name our trustee and our plan administrator? And I always like to narrow those down as much as possible. You'll see other here, plan committee, that is typically the committee that's making investment choices. So everybody on there will be a fiduciary discretionary. The plan sponsor is typically the employer that sponsors the plan, and they may at times be acting as plan administrator or trustee or a discretionary fiduciary.

So anybody within my organization that is doing that could be a fiduciary. So I want everybody to really go back and say, who are these people and identify them so that we can then educate them on what their duties are. So on the next slide we get into those ramifications. What are the risks or what really... First, what are the duties? So ERISA makes it fairly simple. There's a lot of detail here I'm staying at a

high level, but we as fiduciaries have to be thinking about everything from the interest of plan participants, not our own interest, not the employer's interest, but what's in the interest of the plan participant. And we have to be doing this in the exclusively to provide them benefits and to defray reasonable expenses. So one of the big takeaways I want everybody to have today is go back and at least annually work with your vendors and be able to really show what fees are you paying now and is there a way for us to reduce them to reasonably defray those expenses?

Your other major duties are to have care skill diligence and be a prudent person around any decisions that we're making. So think about that. That means anytime a fiduciary is working on a plan issue, they need to be careful, they need to be diligent, they need to be prudent, ask questions, get information, and make sure you are thinking like a prudent person would in any situation. We need to diversify our investments. We need to make sure we have a diversified portfolio. We'll get into that with our CAPTRUST folks. And then the big one for me is you got to follow the plan documents. So again, trustee, go read your trust, make sure you're following the trust document. Plan administrator, that document is huge. There's so many policies, procedures, quadros, claims procedures. And we really need to make sure we're following all of that day in and day out.

Do your duties. And really embedded in all these duties is how can we not educate everybody around this? We have to be educating people about our diversified portfolio, about the prudent processes we take. So really think about education around every one of these duties that I'm talking to you about. And the big one is monitor everything. There has to be a process of monitoring your vendors who are really the people helping you do this. Your third party administrator is doing the planned administrator's work. We got to monitor them. If we have an investment advisor, we have to monitor what they're doing. How are we doing that? What are the processes and procedures? And you need the tools to be able to do this, which means a lot of different people inside your organization and without, who may or may not be fiduciaries.

So on the next slide, what we want to highlight here is we identify who the fiduciaries are and make sure they know their duties and then work with your vendors to document they're doing their duties. But anything that is not fiduciary is what we call plan settler. It is outside of fiduciary duties, which means really to me, it is no longer has to be thinking about the plan participants. You can think about what's best for the employer and you can think about what's best for the business and for everybody. So it's important to distinguish and from a legal perspective, if it's fiduciary, I cannot keep it privileged. I can't keep it confidential from my client, but if it's planned settler, I can keep it privileged and confidential.

So think about how important it is to distinguish between what's fiduciary and everything else. And ERISA calls that the two hat doctrine. So I typically represent companies that sponsor plans, and I need to make sure that my company understands when it's a plan settler and wears that hat. But there may be times that the plan sponsor becomes a fiduciary and know when that's happening and how to protect and know that we're exceeding our fiduciary duties. Okay, thank you all for letting me lecture about fiduciary law. It's kind of my big pitch, but if you do your duties, if you find your fiduciaries, educate them on their duties and show us that you're doing them, best legal protection I can give to you. Thank you. And I'll turn it over to Cat to take over and go deeper.

Trudy:

Yes. Thanks, Joshua. So now that we've affirmed who a fiduciary may be and that the management of plan assets and investments is a fiduciary function, let's explore what naturally comes next in the decision tree for retirement plan investment menus. So on slide eight, which is what we're looking at here, plan sponsors can choose to manage plan assets and investments themselves, meaning they can maintain full discretion over their retirement plan or they can shift responsibility to an advisor. ERISA

defines two possible advisor specific fiduciary roles that a plan sponsor could choose to shift responsibility to.

One is an advisory or non-discretionary role known as a 3(21) investment advisor, and the other is a discretionary role known as a 3(38) investment manager. In a 3(21) or advisory capacity, it's more of a shared liability dynamic where the advisor will recommend investment options for the plan. They'll monitor those investment options, recommend changes if necessary, and the advisor would own the liability for the tools and the analysis used to make those recommendations. In this type of an arrangement, the plan [inaudible], excuse me, the plan sponsor still select-

Trudy:

This type of an arrangement, the plan sponsor still selects all investment options for the plan and they maintain the liability for those investment decisions. In the 3(38) or discretionary capacity, more responsibilities taken on by the advisor. The advisor will select investment options for the plan. They're going to monitor those investment options and they will make changes if necessary, and the advisor will then own the liability of those investment decisions. In this type of an arrangement, the plan sponsor is then responsible for monitoring the investment manager themselves. As a regulatory and legislative bodies place more and more arduous requirements on plan sponsors, more plan sponsors are realizing the value of discretionary ERISA 3(38) relationships with their investment consultants. Some committees realize that they do not have the expertise or even the desire to take on the fiduciary liability of monitoring plan investments.

And in these cases, a discretionary relationship can help shield the plan sponsor for the responsibility for many, but not all of its fiduciary obligations. We see the segment of the market growing significantly in the future. So if we move on to slide nine, as a plan sponsor, whether you choose to maintain a discretion over your retirement plan and manage your investments yourself, or you choose to shift responsibility to an advisor, a logical next step in your retirement plan investment menu process would be to an establish an investment policy statement. This is not a required document, but it is widely viewed as a crucial first step in ERISA conformity. An investment policy statement is written document designed to provide guidance and to establish a decision-making process for planned fiduciaries regarding their investments. A well-written IPS, which is the investment policy statement, should provide measurable criteria for evaluation, which should also be flexible enough so that fiduciaries can exercise their authority for making decisions that are in the best interest of the participants.

This document establishes the roles and responsibilities of the committee members that are making investment decisions, perhaps, as well as an advisor or consultant of applicable. It helps to identify how often the committee would meet to review, and it establishes the reporting criteria that you would use to monitor. The IPS also identifies the appropriate investment asset classes that you may consider for inclusion in your plan menu. Ultimately, it provides a roadmap to you, the committee and its members in discharging your fiduciary duties around selecting, monitoring and replacing investments in the plan. An investment policy statement is one of the most efficient ways that you can help ensure that fiduciaries like yourself adhere to a prudent process and are meeting your fiduciary obligations. Once established though, it should be routinely reviewed to ensure that you are adhering to the document and updated as needed to include regulatory considerations. Before we move on to the next step in retirement plan investment menu decision tree though, Josh, from your perspective, is there anything that we might be missing or that you would add to the investment policy considerations?

Joshua Sutin:

No. You know what I love, Kat, is just that you mentioned you got to review your investment policy, so it's a great way to document each year or so that you go back and look at it and make sure that that becomes part of your minutes or document that you are following the investment policy, reviewing it and staying within its guidelines. And the process of creating it in and of itself is a wonderful way to show the diversified portfolio theory we need to show for fiduciary duties.

Trudy:

You're absolutely right. Thank you, Josh. So if we go ahead and move on to the last slide, once a plan sponsor is determined if they're going to maintain discretion or if they want to shift responsibility out, they created or reaffirm their investment policy statement. The next logical step in this decision tree is the actual construction of the investment menu array. At a very basic level, plan sponsors are only required to offer three diversified investment options. Typically, it's a stock fund, a bond fund, and a capital preservation fund. But we recognize that for most investors, that is not enough options to make a meaningfully diversified portfolio. On the flip side, too many investment options can create choice paralysis. I think of it like the Cheesecake Factory effect. Their menu is literally a book with pages upon pages of options to choose from. I make decisions for a living and I usually go with one of the three specials that they tell me about because I can't make a decision based off of the menu.

So when responsibility is shifted to CAPTRUST from our plan sponsors in either a 3(21) or an ERISA 3(38) capacity, we attempt to simplify the investment menu construction by who we are trying to solve for. Some participants are looking for a do it for me approach. Typically, this comes in the form of a professionally managed off the shelf asset allocation solution that qualifies as a qualified default investment alternative or a QDIA. The next type of investor though is not quite ready to go at alone, may never be ready, but is engaged and would like some support in their investment decisions. We tend to think of them as the do it with me type. Typically, this comes in the form of a professionally managed custom asset allocation solution or perhaps through advice offerings. And the last type of investor would prefer to make investment decisions on their own. This is the do it myself investor. Both the do it with me and the do it myself investor needs investment options available to satisfy their goals and objectives. We typically break this down into manageable tracks that provide two very distinctly different opportunities. One track allows for investment options that provide low cost broad market exposure without active management risk on top. And the other track gives investors the opportunity to outperform passive index options, but perhaps at a premium expense. So I'm going to pause there and I'm going to turn it over to my colleague, Kevin, so that he can peel the onion back further and specifically identify what types of asset classes we consider for the different types of investors and ultimately their investment array tracks.

Kevin:

Okay, thanks Kat. Good afternoon everyone. Thanks for being here. So we'll start, and I think that the big thing is when you're looking at creating the investment menu, it's really creating the menu first and then once the menu's done, filling the investments within the different asset categories. I kind of look at it like if you put new furniture in a room, you're going to measure the room to figure out what's going to fit and what doesn't fit before you just go out and start buying furniture. So it's a similar type thing in terms of creating the investment menu, and it's a complicated process as Kat had mentioned. So really what you're trying to do is you're trying to build a menu that provides an array of investments opportunities that give your employees the best potential of a successful retirement in a manner that they're comfortable with.

So as Kat said, we had the three different investor types. So how do we do that? And there are some overriding guidelines that we utilize in terms of building the menu. I kept mentioning a couple of them. First of all, you have regulatory guidelines. You have 404(c). One of the guidelines of 404(c) is you have three different investment types, which she said a money market, a fixed income and a equity fund meets that requirement of 404(c). They also have the qualified default investment alternative, the QDIA regulation, which gives you a protection if you're going to default somebody who doesn't make their own election, which came about in the Pension Protection Act of 2006. Again, so you have some regulations in terms of how you put this together. The second thing really is really looking at some modern portfolio theory statistics and in terms of how do we create a lineup that is diversified to give people different access to different investment types now that are not fully correlated without, again, as Kat said, overloading the investment options so that's where it starts to become a little bit more difficult.

And then you have behavior. There's plenty of research out there that says the greater number of funds, the lower your participation rate's going to be because people, again, just get paralysis by analysis and they just don't make decisions. And then the third thing, and this is really where each of you is going to differ, it's going to be environment. So your corporate environment, your employee base, are they more sophisticated investors, are they less sophisticated investors? Who your service providers are going to somewhat limit sometimes, not as much as in the past, but still can limit some of the investments you have [inaudible] are available to you. So you kind of use all four of those try to build a lineup that meets all three of those that do it for me, to help me and to let me do it myself.

So we really have come up with kind of a tiered approach to it. So tier one is the allocation tier, and that's typically for those people who are, do it for me or people who are auto-enrolled and don't even get into the plan. So it's the people who just set it and forget it. And typically, that would be something that qualifies your qualified default investment alternative. So a target date or risk-based fund is in that tier. And typically, we have one investment option within that category. So a series of target paid funds is considered one investment option. A series of risk-based funds is considered one investment option. So again, in terms of ease of understanding and educating employees as well as keeping the number of funds limited, we look at one fund in that allocation tier. The second tier is the passive tier. And that's where we're really, as Kat said, those employees who are just looking for market performance.

They want low cost, low investment expense, but really want to be able to participate fully in the market and they're not worried about trying to outperform the market. And that's the passive tier. Typically, we have four to five funds in that category. As you can see on this slide, a well diversified bond fund, a domestic large cap fund, domestic small and mid-cap. Sometimes that's one, those can be two. And then really international that includes both developed in emerging markets exposure. So you have really exposure to about 96% of the investible world at a very low cost. And then the third tier is really the active tier. So that's for people who are willing to pay a premium to try to outperform the market or the benchmark. So those are funds that are looking for people who are willing to pay for the potential of outperforming and getting better performance than what they could on a passive fund.

So that one is a little bit broader. We [inaudible]. All of the funds in these funds are still... The two big keys are they're well diversified, so we're not putting anything that's undiversified. And the second thing that we really focus on is these are funds who have a risk return profile suitable for someone who's saving for retirement. So there's a lot of really good funds out there, but not all of them are designed for someone who's saving for retirement, really want to monitor that risk and manage that risk of the funds that are available to them. So that's what we look at. And you can see we usually have anywhere between nine and 11 funds in that active tier. We have a capital preservation fund, which is your cash fund or your really conservative low risk fund, typically an intermediate term bond fund.

So a well diversified access to the entire fixed income marketplace, both domestically and internationally with a manager basically picking and choosing when to be in what asset class. And then on the US stock, we have typically three US growth stocks, so a large cap, a mid-cap and a small cap. And then three US value funds, same thing, large cap, small cap and mid-cap. And then a diversified international fund, one to two diversified international funds. And that really gives people the ability, again, access to the majority of the investing world, managers who manage in a way that's suitable for retirees, retirement saver, and gives them the ability to have some non-correlated asset classes in there. And then the fourth tier is really kind of the other tier. So that's for something who, again, this is really a [inaudible] a lot of times where the environment comes into play.

So people who are maybe have employees or participants who are looking to invest outside of their core. So you could do something like a self-directed brokerage window where you could offer participants' ability to put money outside of the core lineup into a self-directed brokerage window, and that can be done in one of two ways. It can be done with basically any investment that's eligible under ERISA could be included in that. Or what a lot of companies do is they just do a mutual fund window. So you can only invest in mutual funds that wouldn't be available in the plant. So if somebody wants to invest in a fund that's dedicated to China, instead of putting that in your lineup, that could create risk for people who don't use it properly. It gives them access to that without, again, making fund too risky, the lineup too risky or too many funds.

The other one that we're seeing a lot that you do see is companies who have company stock, if you're offering company stock in your plan, that falls into tier four. And the other one we're really seeing now that's been in the news a lot is ESG or environmental social and governance funds. So this is a big debate. I think everyone has seen the debate back and forth in terms of what, and we'll talk a little bit more from a monitoring standpoint on that, but that's another fund that some plans are now looking to add something in the lineup. The participants are asking for a fund that kind of meet some of those ESG requirements and that would kind of fall into that other territory as well. And then if you have sector funds, like we have clients who are biomedical companies who want to have a healthcare fund or a technology company who wants to have a specific technology fund, again, from that environment standpoint, those would all kind of fall into that other territory as well. So we go to the next slide-

Joshua Sutin:

Sorry, Kevin, real quick before you go forward, I love this construction process and how you document it for people and I get the tier one, tier two, tier three and how you guys break it. I think that just really is brilliant because it makes a very complex process a little bit more easy to understand and fill out. That tier four when we get into brokerage, I worry about that and you said it, if some people can invest in anything under ERISA, and that worries me from a fiduciary perspective is how are we monitoring what our participants are doing and do we have responsibility over that brokerage window? And you mentioned ESG, environmental social governance, is a big issue in the investing world. And ERISA [inaudible] the DOL have very strong feelings that they've gone back and forth on.

Joshua Sutin:

And the DOL have very strong feelings that they've gone back and forth on over ESG. So I guess more than a question, Kevin, although I want your comment, is that it's those self-directed brokerage accounts that aren't limited to something like the mutual funds that allow you to do it, to give you some kind of protection. I would just warn my fiduciaries that they better be doing a lot more duties and processes around those types of brokerage accounts. Your thoughts?

Kevin:

Yeah, no, I agree. And I think that's because historically, as you know, the thought was you have to monitor the account, like the fees and the process and so forth, but you weren't required to monitor the investments underlying the brokerage account. But then last year the Department of Labor issued the ruling about crypto, which they had mentioned that you were potentially responsible for crypto within the brokerage account. So there's now a precedent for [inaudible] your opinion on this, for the Department of Labor to now say, " As a fiduciary, you do have more responsibility for what's in the brokerage account."

Trudy:

[inaudible]

Joshua Sutin:

[inaudible]

Trudy:

Oh, I'm so sorry. I was just going to say, the best bet is that it was just a bulletin that they put out it. It was just guidance and a bulletin and not necessarily a ruling, but it certainly increases the scrutiny around the potential investment options that are made available, which is why I think it's so important that if plan sponsors are going to be considering it, either on their own in a vacuum or working with a consultant like CAPTRUST, that they understand and fully vet out the implications of having this type of window available for the participants. Not only from how expensive is it? Is it competitively and appropriately priced for the solution that it is? But are you receiving or monitoring to see if there are any potential complaints or issues with this particular window? What's the percentage of potential utilization?

For most of our plans, we see less than a 1% to 2% utilization of this type of feature for plans that are using it. But just monitoring if there is an uptick in utilization and understanding the why, because that could be leaning towards maybe trends that maybe are unfavorable for the core menu, and then understanding what you are giving them access to within it. So there's certainly lots to unpack there and why having a strong partner is so important in understanding the complexities of a solution like that.

Kevin:

Yeah, that's a really good point. And that ties into where I was going to go next. And that's once you have that menu defined, then it's really filling that with investments. So how do we go about selecting investments and how do we go about monitoring those investments once they're in the plan, in each of those different tiers? And remember, it doesn't matter if, as Kat said, if you choose a 321 investment where you make investment decisions, or you're at 338 where you're outsourcing that. You still have a fiduciary responsibility to monitor that process, either the process you're making or the process that your investment manager is making. So it doesn't matter which one you choose, you still have a fiduciary duty to monitor that.

So in tier one, the qualified default investment alternative, that's become such a big part of defined contribution plans. It actually had, we have actually a special conversation on the selection and monitoring of that. So I'm going to defer on that a couple minutes and Kat's going to go through that in more detail. So let's talk about tier two and tier three, in terms of how do you select the passive funds. I think one of the keys is you don't want to have the same analysis for your passive funds as you do for your active funds. So your passive funds are not taking any additional risk other than the market risk

that they're investing in, the established benchmark that they're investing in. So you don't want to put them under the same risk return measurements that you do in active funds. So in those funds, you're looking at things like cost. You're looking at their tracking error. How closely do they track the benchmark? You're looking at the reputation, you're looking at the manager experience. So that's really how you fill those boxes and then you monitor those going forward.

For the active tier, I think that's where you're going to do a little bit more. It's going to be a little bit more research and take a little bit more thought and process into that. You really want to look at not only expenses and the manager expenses, you want to really get an idea of how they invest. So what I talk about is the three Ps; the people, the process and the philosophy. So who are the people making the investment decisions? Are they the people who had earned the returns that had them show up [inaudible] first place? So you want to make sure of that, or that they leave and somebody else is selling off of somebody else's performance. Their philosophy. What's their philosophy? Overall philosophy in terms of investing, and this is where it becomes important when you're looking at investments that are suitable for someone who's saving for retirement. Again, you don't want to invest in, I like to say with an investment retirement, you want to raise the floor, you're willing to lower the ceiling, but raise the floor. The worst thing you can do for a retirement, especially with somebody who, this is the majority of their assets, you don't want to have them up 40% one year and down 30% the next year. Historically, what our experience shows is that's led to that bad behavior where they would be basically saying, "Oh, this fund was down. I have to sell out of that. Oh, that fund was up, and I'm buying into that." So they're selling low and buying high. So you want to be able to monitor that.

And then you want to see how is their performance compared against their peers and so forth. So then again, our philosophy is each of these asset categories, you want to pick one fund per asset category. So again, to limit those numbers, to limit confusion. And if somebody does a questionnaire, they say you should be 20% large cap growth. They know exactly where to put their money. They're not thinking, "Well, now there's three different funds. Which one do I do? Do I split it evenly?" So it just makes it an easier process for participants and gives you, from a fiduciary, gives you a good solid process to be able to follow.

The one thing I'll just talk on real quickly, since it was brought up, before I turn it over to Kat, is in that tier four of that ESG. As we said, there's been a lot of debate on ESG. The previous administration introduced us all to the word pecuniary, in terms of a requirement for having a fund within a lineup. The current administration removed that. They now say basically simplifying, if participants are asking for ESG funds, that you should fulfill your fiduciary duty by adding them based on that participant desire.

However, there are multiple ESG lawsuits across the country, both on the Department of Labor regulations and then plans being sued for ESG funds they have within their lineup. So then you have the chance of a change in control of the White House in an election next November. So I would say be careful. I mean, if you're getting it, you really want to put a lot of scrutiny and have a process behind this because of, first of all, because of the volatility, because of the different reaction from either side of the spectrum. This one's one you'd really want as a fiduciary, and I'll let John fill in after this, really want to go through an extra process in terms of monitoring and documenting, if you're going to put this into your plan.

Joshua Sutin:

Kevin, this is brilliant. So let me jump in real quick. We had this happen to us. So at my law firm, we had a lawyer call up the committee and write us and say, "I really want this ESG fund, will you consider it?" And it was a first for us as a committee, but it actually was easy. We took it in and did our usual process. Now, full disclosure, and I'm not getting paid, CAPTRUST is our firm's representative. So it was very easy

for my committee. We took that suggestion and gave it to our investment advisor and said, "Go analyze it, compare it, show us how it does under our investment policy statement and under our performance requirements that we have set up and built into our diversified portfolio." And CAPTRUST went off, brought it back to the committee and explained to us why we really, as a fiduciary committee, should not add that fund because of its lack of performance.

It wasn't based on anything emotional or political or anything like that. It was completely a rational, here's how we expect our funds to perform, and it doesn't perform. And that was our way of process and procedure to make sure that we were doing our fiduciary duty of considering it, because it was brought to us, but also the process of showing why we as a fiduciary did not feel it should be added. And we could not have done that on our own. Lawyers, I can't go do that process. And most businesses, most of my clients are not CAPTRUST that have so many people who can go do that and help with that process. And I'm not just pushing CAPTRUST, any of your vendors, use those vendors to help you do these type of processes and procedures. Thank you.

Kevin:

Thanks John. That's really helpful. So with that, I will turn it back over to Kat and she can talk about the QDIA selection and monitoring process.

Trudy:

Thanks, Kevin. Well, we've covered the different types of investors, the tracks that we consider and that we build to meet their needs. And now little disclaimer, I'm going to share relatively broad generalization, and that is that roughly 90% of plan participants are looking for some type of do it for me solution. Or do it with me. They either want to work alongside someone or they want to wash their hands of it and they just want someone else to do it for them. The remaining 10% want to construct their own portfolios or do it themselves. And typically only about 1% of participants can actually do it effectively well in choosing their investment structure for their retirement savings goals. So this is why so much attention and scrutiny is placed on the types of structures that we place in the tier or track one, which is the qualified default investment option, because literally either by default or actively choosing this option, this is where the bulk of plan assets are going.

So if we take a look at slide 12, this is showing you a little bit of the history and the evolution of the default space. Prior to the Pension Protection Act, a little history for you, of 2006, most plans were defaulting into what are considered capital preservation funds. The problem with capital preservation funds is that outside of rapidly rising rate environment, they don't typically keep pace with inflation over time. So with the introduction of the PPA in 2006, they set some guidance on the type of investment options that plan sponsors, fiduciaries could consider. It needs to be a diversified option and it needs to be in consideration of your participant demographics.

So you had three options really available to you. You could consider a managed account, which back in 2006 wasn't very competitively priced as it is today. You could look at some type of risk-based fund. The problem with that is you have to pick a risk. Typically, most plan sponsors will pick a balanced risk, which is like a 60/40, which is a 60% equity, 40% fixed income portfolio. That might work for someone that's nearing retirement, but may not be suitable for someone who's 25.

So the predominance or the most widely adopted solution became target date funds, because target date funds are the only solution that existed at the time that was decently priced and allowed for the asset allocation to start at a more age appropriate equity exposure and to de-risk over time as you move closer and closer to your retirement goals. So what has that done to the target date funds landscape?

And really it's done a lot of potentially really good things. Most of the good things have come with cost structures.

Mutual fund structures for target date funds previously were a total weighted average of the underlying fund expenses for majority of fund managers. That potentially made it cost prohibitive and very difficult for fund managers to reduce the cost over time to make it more attractive as more and more dollars were going there. So many fund managers have actually changed the way that they price their mutual fund options and they now do a top down just flat, this is the cost, to manage, from an investment management perspective, manage the asset allocation. And it's really been able to drive down the overall cost at the mutual fund level. And this was great because it took some time to make the changes on the collective investment trust side.

Collective investment trust is just another vehicle that offers the same solution as a target date fund, but has a different regulatory or governing body. So the reporting requirements on it are a lot lighter, which allows for them to be a lot more cost-effective. The problem is that in 2006, most of them had a very, very high threshold or benchmark for entrance, which means you'd have to have a large plan, a lot of participants to even gain entry. So it was prohibited to plans gaining access.

So in that time, the way that they've evolved is they've lowered the point of entry in most cases to zero. So you could have startup plans potentially gaining access if you're a 401K to a collective investment trust. And the cost structures on those are typically much more favorable, sometimes towards the 15 to 20 BIPS, if you will, from their mutual fund counterparts, more efficiently priced. So there's been really, really strong improvements on the cost structures, which has allowed for more participant savings to go further for them over time.

Another evolution that we've seen in the target date space, and unfortunately it's just relatively too early to say whether or not this has been a positive trend or not for participants, but one trend that we've seen in the target date fund space is that over the last 10 years, there's been a shift, a higher equity shift, and a lot of target date managers, in how much equity exposure they are allowing for participants. And they're flattening out the glide paths. So not only do they have higher equity exposures potentially, but they potentially have higher equity exposures over a longer period of time. It's too early to say whether or not that has been a boon, a win, or not, but we are monitoring it, as you can imagine, to make sure that we are in alignment with how those have been moving.

The next phase or where we think the evolution is going for defaults or QDIAs is some type of maybe interactive or connected approach where maybe you still offer an off the shelf target date fund offering like we are today. But in addition, you would allow an elective option, an elective choice for your participants in a managed account solution.

Trudy:

... elect a choice for your participants in a managed account solution. The difference between a managed account option versus an off-the-shelf is that an off-the-shelf option can only get so close based primarily on the year you were born to customizing your profile or your approach to your retirement savings goals versus a managed account solution has the ability to get much more personalized and much more customized to ones unique situation. We believe that this should be an opt-in and engagement level type feature, so I think you're going to see some trends where they are used in conjunction with each other and versus one versus the other. But as the default option continues to be most predominantly the target date fund space, it's really important to focus on your fiduciary responsibilities on how you consider and select that fund.

So if we go ahead and move to the next slide, given the wide adoption, the DOL published eight tips. They actually published these tips in February of 2013. So if you were unaware of this, then let me be

the first to tell you. But there are eight tips and seven of them are very specific to the actual selection process, and one of them is how you should monitor it from there. Six, well, that's not true. We'll call them four to five of the tips are very specific to how you should be monitoring and looking at the different investment managers from a performance standpoint, but also from a glide path standpoint. Everything from the underlying funds, any assumptions that the manager may be using in connection with their glide path, understanding if there's an income replacement component that they're looking for, maybe even a targeted retirement age. Perhaps it's the same or maybe different than the normal retirement age you have in your plan document. Maybe there's an average deferral rate assumption that they're making about your plan participants.

You also need to understand how frequently they may rebalance if they're a strategic or a tactical type of manager, and if they make active investment decisions under the hood or if they allow for passive or combination of the two. This is just scratching the surface though, because understanding the complexities of a target date fund and its glide path and how they're managed is only one element of what they are saying, you as a fiduciary need to understand. The second element is that they want you to understand your people, your demographics and the potential implications on the target date fund that you may choose. And this is everything from understanding your average deferral rates. What are your current salaries? What is the age of your participants? What trends can you observe on your participants once they hit retirement age and once they retire, is the money staying? Is it going? And typically, how long do they stay in the plan?

These are all important questions that is really, really insightful for you as fiduciaries to understand so that when you're looking at the assumptions that the target date fund providers are making in their glide path management, you can align your decisions with those options that are available to you. And then once you've aligned with strategies that meet your demographics and you've identified performance that's in alignment with your investment policy statement, the next thing you have to identify is the investment options that are, I'm sorry, they have cost structure options that are available to you to choose from. And as we mentioned before, you have mutual fund options. You have collective investment trust, and in some cases, depending upon your plan, you may even have separate account options to consider, but you want to make sure that you're using the most efficient strategy for your demographics and plan size.

And then the last thing that you have to do as fiduciaries is determine your strategy for how you're going to communicate. The communication requirements are both required, but also there's an element of how much you want to communicate, what purpose of this default investment is for your participants, what a target date fund is and how they can leverage it for their situation that you need to determine. So with that, I'm going to turn it over to Joshua so that he can talk through communication efforts for this, but also just in general, what are some of the other fiduciary communication requirements that our plan sponsors face?

Joshua Sutin:

Yeah, Cat did a great job of showing how complicated what we all think is simple. And so we hit a lot of fiduciary duties here by qualified default investment. If somebody doesn't choose how to invest, we have protections against fiduciary claims against us, but target date funds are what we're all using these days or so many of our participants are using. So by doing all the things you're talking about, you're actually really showing that prudence care diligence around a huge part of our investment pool. But ERISA and the Internal Revenue Code also really require that we give people a lot of different notices around fees, around the funds. We have to provide a lot of information to employees if we want to take advantage of QDIAs or Kevin mentioned before, a 404(c) where we push investment choices down to participants. We really have to show that we're following all of those duties and doing that. And a lot of

it is getting information to participants. So education becomes part of our duties here to make sure that we are doing all the things that we need to do. Kevin, thoughts?

Trudy:

[inaudible].

Kevin:

I think we're right on track. So I'm going to transition real quickly to the related fees, which is the last big thing from a fiduciary standpoint. We're talking about investment menu, and I'm going to go really high level because this is something we could spend another hour talking about easily. So really I want to start with just what are the two different fees within defined contribution plan in a large sense? So there's your plan related fees, which are your record keeper, your administration, your advisor, your legal advisor, and so forth and so on. And then there's investment management fees, and that's the fee that's being paid by the people by [inaudible] who are investing into different investments. And those fees can be independent of each other or they could be codependent, one could rely on the other. But let's start with really the three ways a defined contribution plan related fees can be paid.

So really there's three. So one is you can pay at a corporate treasury. So you as a business owner or a board of directors could decide where just to provide the service and pay the fees on behalf of our employees. The second way is a participant directed charge. So there's a charge that gets directly charged to participant account. That could either be a percentage account, so maybe a quarter of 1% of assets on a quarterly basis, or it could be a down on $25 a month that could be done. Or the third way is revenue sharing from the investments in the plan that could be used to cover or offset the overall cost. So the good question is, what is revenue sharing and where is it come from? So revenue sharing can come from the investments within your plan.

Now, there are investments that don't ever have revenue sharing. A passive fund almost never has revenue sharing because the expenses would be so high, you're going to trail the benchmark on a regular basis. But really, let's start to break down the components of the investment management fee. So it's mentioned you had the fee that the advisor gets paid to manage the fund. So there's the investment management fee that pays for salaries, trading costs, analysts, all of the things that are involved in the rent and the office space and so forth. All the things are involved in running the investment. And then second of all, there's a revenue. There could be revenue sharing, and that's a portion that's paid by either the fund or the fund manager that goes to help offset some of the cost of adding access to the plan. So they probably provide that to a record keeper for using their fund within a particular investment lineup or in multiple investment lineups.

Now, it's not illegal to have revenue sharing, it's just one, again, we talked about and we'll continue to talk about, and this in all the trainings, having a process and documenting that process and determining exactly how you are going to have those fees paid. And then if you do have revenue sharing, there's really two potential uses for that. You can use it to pay plan related expenses that we talked or you could rebate that back to participants. And there's multiple ways to do that. Again, that that's a whole nother topic. But those are the things that you can do with the revenue sharing. And again, it's gets back to everything else.

I'll turn it over in a second to Joshua to kind of put more color on this, is you have to have an idea to have a process in terms of why you're selecting the fee payment method you are. And then you have to document the rationale behind doing that. So there's no one right or wrong answer. It's just like everything in ERISA. It's a process based regulation. So Joshua, I'll turn it over to you to kind of talk a

little bit more as we get towards the end in terms of how fiduciary goes about documenting that fee discussion.

Joshua Sutin:

Yeah, I think you've hit this right on the head. If you go towards revenue sharing, this is the reality of the way that plans are charged. So we as fiduciary need to understand all the fees the way they're charged, compare them to one another and make sure we got to defray reasonable expenses. So we need to be going back every year, at least every year, and really looking at our investments and comparing them to other options to make sure that we're keeping our expenses at the lowest. And if revenue sharing can do that and you can show me the process that proves that to me, great. But if you haven't done a process to show me, then I worry about revenue sharing because it means money's moving around among parties and it just adds to potential fiduciary breaches or plaintiffs saying, "Oh, well, you're getting paid more. You could have done it this way and got paid less." And if we can't fight that, that's when I'm starting to worry. So we really need to be able to document why we're always defraying reasonable expenses. Cat, your thoughts.

Trudy:

I think that you're right on. I would've love to show everyone is if you go to the last slide, Joshua was really great with arming us with some of the required communications that as fiduciaries you need to be mindful of throughout the year. So if we go to the last slide, I think you've touched on some of these already, but is there any others that you would want to highlight just to wrap up the required notice conversation?

Joshua Sutin:

I'm really big on our fee notices. We have fiduciary duties as the investments to know what fees are being charged against the plan. And we got to make sure we understand them and know them. And then we got to turn around and tell employees. And it's a real art. Most people bury it and try to hide it. I think we should embrace our duties and all of these required notices and things or communications, we absolutely, they're fiduciary. So we really want to be careful and make sure that whatever we say is accurate and true in what we think. So read it twice, make sure you'd be comfortable showing it to your mother and you're probably good, but it's very important, and I believe we should take advantage of this to educate our people and use these notices not just to comply, but to really help people understand how to invest for retirement and how to save and to become better financial wellness, I think is a great new term of art that I hope we all utilize both at the fiduciary level, but in the best interest of plan participants. Thanks, guys.

Trudy:

I agree. We get asked that question a lot from our plan sponsors on what they could be doing to support their duties in terms of what's required and how they get the information out so that their participants understand, which really speaks to the growing trend that we've been seeing over the last 12 to 18 months, which is just around the financial wellness and advice. And if that's something that you guys listening in today have not implemented in your plans today, make sure you mention it with your CAPTRUST partner. This is certainly something that is available to you and can be vetted. We certainly have solutions and resources available to support these efforts, but we also can help you in a thorough process in identifying what solution is best for you and your [inaudible].

Dawn McPherson:

Thank you all. This has been fantastic. We received so many great questions in the chat. I was hoping we'd get to them on the call, but because we're one minute to stop here, I want to assure all of you listening, if you submitted a question, we will pair with your CAPTRUST advisor. If you don't have one, we will respond to you and follow up with the answer and some additional guidance for you. Kevin, Cat, Joshua, thank you for sharing your wisdom, your knowledge, your perspective. It's really helpful to hear the perspective each of you brings to these topics. And thanks to each of you who have joined us, we hope you'll join us for our fourth quarter webinar and continue on with the series. Have a great day.

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