Dimensional

FIDUCIARY RESOURCE GUIDE

FIDUCIARY RESOURCE GUIDE

Developed for Dimensional Fund Advisors by Ian S. Kopelman,
a Partner at DLA Piper LLP (US)

Ian S. Kopelman
Partner, DLA Piper

Ian S. Kopelman, a partner at DLA Piper LLP (US), has extensive experience in ERISA and is responsible for all matters involving retirement and other fringe benefits programs for clients ranging in size from major publicly held corporations and public benefit plans to sole proprietorships and partnerships. Mr. Kopelman's experience includes designing and drafting both qualified and non-qualified retirement and deferred compensation plans, including leveraged employee stock ownership plans. He regularly counsels clients on plan implementation, administration, operation, and communication. He also works extensively in the area of employee welfare benefits plans.

Throughout his career, Mr. Kopelman has published numerous articles on issues and trends in the area of employee benefits. In addition, he has served as an Adjunct Professor of Law at the John Marshall Law School. Among his many recognitions, Mr. Kopelman has been included in the annual editions of *The Best Lawyers in America*© for employee benefits law since 2007. The Leading Lawyers Network cites him as an Illinois Leading Lawyer, and he is listed in *Who's Who in America*, *Who's Who in American Law*, and *Who's Who in the World*. Additionally, Mr. Kopelman has been named an Illinois Super Lawyer as the result of a research project conducted jointly by *Law & Politics* and *Chicago* magazines. He has also been recognized by The Legal 500 United States.

Virginia Lewey
Attorney, DLA Piper

Virginia Lewey, an attorney at DLA Piper LLP (US), started her legal career as an ERISA trial attorney with the US Department of Labor in Washington. She currently counsels clients on retirement and welfare plan compliance and benefits considerations in mergers and acquisitions.

Blaine Aikin, AIFA®, CFA, CFP®
Fiduciary Subject Matter Expert,
Fi360, Inc.
Founder and Principal,
Fiduciary Insights, LLC

Blaine Aikin is the Founder and Principal of Fiduciary Insights, an independent provider of fiduciary subject matter expertise for organizations that employ or provide services to investment advisors.

Before founding Fiduciary Insights in 2019, Mr. Aikin served in the executive leadership of Fi360, Inc. He progressed from Chief Knowledge Officer to CEO in 2007, became Executive Chairman of Fi360 and CEFEX in 2016, and continues to serve as Fiduciary Subject Matter Expert for Fi360.

Mr. Aikin also served as a Director of the CFP Board of Standards from 2013 through 2016 and Chair of the CFP Board in 2017. Currently, he chairs the CFP Board's Standards Resources Commission that is tasked with providing guidance on the new code and standards to CFP® professionals.

Aikin holds a bachelor's degree in economics and political science from Allegheny College and a master's degree in public management and policy from the Heinz School of Carnegie Mellon University.

Warren Cormier
Executive Director Emeritus,
DCIIA Retirement
Research Center

Warren Cormier is Executive Director Emeritus of the DCIIA Retirement Research Center (RRC). He previously served as CEO and Cofounder of Boston Research Technologies and as President and Founder of Boston Research Group. He has more than 25 years of experience in research for investment companies, banks, and insurance companies. He is also recognized as a market research leader in the defined contribution industry. Mr. Cormier is the Cofounder of the Behavioral Finance Forum with Shlomo Benartzi, PhD, a Professor Emeritus and Cofounder of the Behavioral Decision-Making Group at UCLA Anderson School of Management.

Dimensional Fiduciary Resource Guide

December 2020

Dimensional Fund Advisors is pleased to present the *Dimensional Fiduciary Resource Guide*, authored by Ian S. Kopelman, a partner at DLA Piper LLP (US), except as otherwise noted. Becoming a fiduciary for a defined contribution (DC) plan is a unique opportunity to positively impact millions of Americans saving for retirement by targeting better outcomes. The associated fiduciary obligation—to act in the best interest of another party—is based in both law and ethics. Covering many major topics facing a fiduciary today, this "living guide" is designed to be a resource for education and best practices.

The term "fiduciary" is derived from the Latin word *fiduciarius*, which means to "hold in trust." Plan sponsors, and their service providers that accept the role of fiduciaries, are required to "hold in trust" (or safeguard) retirement plan assets and act exclusively in the interests of plan participants.

Advisors, plan sponsors, and their service providers will likely find this guide to be a useful tool for ensuring their plan offering is valuable and relevant. A well-crafted plan can help an employer satisfy many obligations, including assistance with attracting and retaining talent and aligning employees with corporate goals. Plan sponsors, especially, will be able to use this guide to evaluate their plan's efficacy and help plan participants plan for a secure retirement after the end of their working lives.

The guide has five sections:

- Fiduciary Foundations—addressing the requirements for setting up a plan
- Fiduciary Applications—addressing the ongoing operation of a plan
- Additional Fiduciary Considerations—additional topics a plan may want to consider
- Appendix
- Glossary

To address the ever-changing regulatory and legislative landscape governing DC plans, we intend to periodically provide updates for this guide.

Developed for Dimensional Fund Advisors by Ian S. Kopelman, partner at DLA Piper.

Dimensional applauds the advisors, consultants, and service providers that establish and manage retirement plans in the best interests of participants. Our goal is to assist those entrusted with these critical responsibilities. We also encourage you to continue engaging with our firm through in-person training sessions, live webcasts, and ongoing discussions with your Dimensional representative.

Acknowledgements

Dimensional and Mr. Kopelman would like to thank all those who reviewed and commented on these materials and provided invaluable guidance. We also offer special thanks to industry experts Blaine Aikin, Zvi Bodie, and Warren Cormier for their thoughtful feedback and collaboration.

FIDUCIARY FOUNDATIONS

Plan Establishment and Fiduciary Framework ▸
Fiduciary Roles and Responsibilities ▸
Use of Committees for Retirement Plan Governance ▸
Fiduciary Education ▸
Straight Talk on Investment Policy Statements ▸

FIDUCIARY APPLICATIONS

Investment Manager Selection ▸
Participant-Directed Plans, Mitigating Fiduciary Liability, and Qualified Default Investment Alternatives (QDIAs) ▸
Asset Allocation Solutions—Evaluation and Selection ▸
Investment Monitoring and Performance Benchmarking ▸
Benchmarking and Evaluating Plan Fees ▸

ADDITIONAL FIDUCIARY CONSIDERATIONS

Tips for Fiduciary Compliance ▸
Understanding Managed Accounts ▸
Navigating ESG in Retirement Plans ▸
Collective Investment Trusts ▸
Safeguarding Plan Assets and Cybersecurity ▸
Guidance for Employers Offering HSAs ▸

APPENDIX

Sample Investment Policy Statement for a 401(k) Plan ▸
Plan Design and Fee Benchmarking Template ▸
Fiduciary Education, Training, and Certification Resources ▸

GLOSSARY

▸

Dimensional

FIDUCIARY FOUNDATIONS

Requirements for Setting up a Retirement Plan

Plan Establishment and Fiduciary Framework

December 2020

KEY PRINCIPLE

An employer can create a solid foundation for good fiduciary practice by establishing the plan with well-defined roles, responsibilities, and procedures.

Implementing a Retirement Plan

A retirement plan is a highly valued employee benefit. In many industries, a good defined contribution (DC) plan is a competitive necessity.

There are many types of retirement plans. Within each type, the options vary in cost and complexity. Given the context of regulatory complexity and the growth in fiduciary litigation, employers should engage in thoughtful advanced planning to secure the intended outcomes of retirement plan sponsorship.

Settlor vs. Fiduciary Decisions

It's crucial to keep in mind the distinction between business, or "settlor," decisions and fiduciary decisions. Designing a plan entails settlor decisions—the decisions of the settlor (creator) of the trust. These decisions are not subject to the ERISA (Employee Retirement Income Security Act of 1974) fiduciary standards that require the fiduciary to act "with an eye single to the interests of the participants."

SETTLOR (BUSINESS) DECISIONS

- Whether to establish a plan
- What kind of plan
- Choosing the plan's optional terms (within Internal Revenue Code constraints), such as:
  - Who participates
  - How much (if any) is the employer's contribution
  - How long a worker must be employed with the company in order to vest
  - Automatic enrollment
  - Participant-directed investment
  - Distribution options

But once decisions are made to establish a plan and its terms are chosen, implementing the plan requires the sponsor to appoint plan fiduciaries to exercise fiduciary responsibilities.

FIDUCIARY DECISIONS

- Implementation includes a broad range of decisions, which normally include:
  - Selecting a recordkeeper
  - Selecting service providers
  - Ensuring that the plan is properly communicated to employees
  - Selecting an appropriate array of available investments
  - Monitoring the investments or the service providers charged with selecting the array of investments
  - Managing day-to-day plan administration

Once the plan is established, the employer might want to change terms (distribution options or benefit formulas) and, some day, terminate the plan. These actions, however, are not fiduciary functions.

Developed for Dimensional Fund Advisors by Ian S. Kopelman, partner at DLA Piper.

Here is a checklist of 10 key considerations when establishing a retirement plan. (We believe these considerations cover most instances and are therefore comprehensive. However, depending on the industry, goals of the plan, and/or changes to rules and regulations, additional considerations may be warranted.)

1. DETERMINE PLAN GOALS

Prioritize what the company hopes to achieve when establishing a retirement plan. For instance, is the goal to attract the best employees? Improve retention? Provide employees the security of lifetime income?

Know what peers and competitors offer and what employees want. Consider the workforce's demographics and culture.

2. SELECT OR DESIGN A PLAN COMPATIBLE WITH COMPANY'S BUDGET AND ADMINISTRATIVE COMPLEXITY

Retirement plans are generally either DC or defined benefit (DB) plans. DC plans include, for example, 401(k)'s, in which the outcome is an undefined amount of money, meaning that what the employee has at retirement is the sum of any employer contributions, employee deferrals, and earnings. With DB plans, the outcome is the benefit payable at retirement, which is calculated under a formula contained in the plan document.

Beyond that basic categorization, a number of design decisions can help tailor the plan to the company's specific goals and workforce. These choices include eligibility, vesting, distribution options, employer match, automatic enrollment, plan loans, hardship withdrawals, whether the plan or the employer pays plan expenses, and whether participants will direct the investment of their own accounts. Coordinating goals with a realistic assessment of the available budget and staffing is time well spent toward attaining a well-tended, workable plan.

Avoid creating a plan with complicated features that turn out not to have been properly understood or even needed. Correcting operational mistakes is expensive and time-consuming. Minimize them by carefully selecting and understanding plan terms that the company can reasonably administer from the beginning.

3. THINK THROUGH ERISA FIDUCIARY RESPONSIBILITY STRUCTURE

- Basic ERISA fiduciary responsibility. Fiduciaries are required to act solely in the interest of participants and beneficiaries and with the care, skill, prudence, and diligence that a prudent person acting in a like capacity would exercise under similar circumstances and with like aims.[1] ERISA fiduciaries must also avoid conflicts of interest and acts of self-dealing[2] and must administer the plan in accordance with its terms.[3]

  Speaking generally, an ERISA fiduciary is an entity or person who has or exercises discretionary authority or control over the management or administration of the plan, exercises any authority or control over the management or disposition of its assets,

or renders investment advice for a fee or other consideration. Note how functional that definition is. In addition to the roles generally perceived to carry fiduciary responsibility, such as a plan's trustee, administrator, or investment manager, a person or entity may be found to be a fiduciary without intent, authorization, or even awareness of functioning as a fiduciary.

And that matters! A fiduciary can be liable for losses to the plan caused by its breaches of fiduciary duty and, under certain circumstances, for losses caused by other fiduciaries under co-fiduciary principles. Civil penalties and excise taxes are also part of the government's enforcement arsenal.

As you will read throughout this guide, a fiduciary's best defense is the establishment of and careful adherence to procedures for use in various decision-making contexts that are designed to enable fiduciaries to determine and evaluate available options and select the one that is, in their judgment, best fitted to the situation and to ensure a decision is made solely in the interests of participants and beneficiaries, and is prudent and cost effective. For example, written procedures for selecting service providers would set our key guidelines and processes, such as a request for proposal (RFP) procedure designed to result in the selection of a well-qualified provider for a fee that is no more than reasonable.

- Allocation of fiduciary responsibilities. The employer will have fiduciary responsibility in administering any plan it establishes. But the employer can delegate some of these responsibilities to particular persons or committees and allocate responsibility to unrelated fiduciaries by carefully defining and delineating fiduciary responsibilities in plan and trust documents and establishing a process for delegation. For example, if members of the Investment Committee exercise only investment duties, they will not normally be responsible (and potentially liable) for the actions of the Administrative Committee (unless subject to co-fiduciary liability by participating in, enabling, or knowingly concealing the other fiduciary's breach).

  The employer can also insulate itself from potential liability by allocating discretionary fiduciary authority to providers of administrative or investment management services. For example, a company could appoint an investment manager (a 1940 Act advisor, bank, or insurance company) as a named fiduciary (with delegated discretionary authority over the investment of all or a portion of the plan's assets) to select and retain the investment options offered to participants. The employer is then normally liable only if it falls short in prudently appointing and monitoring that named fiduciary investment manager.

  This allocation among various fiduciaries must be clearly delineated in the plan and/or trust documents and should be consistently carried through in service contracts, with the appointed service provider acknowledging fiduciary responsibility and precise duties, and in communications to employees and in the investment policy.

PRO TIPS

- A fiduciary's best defense is the establishment of and careful adherence to procedures for use in various decision-making contexts that are designed to ensure a decision is prudent and is made solely in the interests of participants and in a prudent way.
- Delegate and allocate fiduciary responsibility when setting up the plan. Be sure the delegation and allocation are set out consistently in all applicable documents—plan, trust, summaries, and contracts.

4. DEVELOP PLAN GOVERNANCE STRUCTURE

Good plan and risk management requires determining in advance who makes decisions and how they will be made. Define responsibilities. Decide whether the employer's responsibilities will be exercised through a committee or several committees or by a specific officer or officers. In establishing a committee or committees, specify by title or name the committee members, operating rules, and requirements. Specify how the committee is to work; for example, establish voting procedures, the frequency of meetings to review the plan's operations or investments, and provisions for keeping and retaining minutes to memorialize decisions and the reasoning supporting them.

5. DETERMINE SERVICES NEEDED TO OPERATE PLAN

Understand what needs to be done, depending on the specifics of the plan, as well as compliance, transaction, and participant disclosure obligations. Tasks likely include:

- Drafting or reviewing the plan document, trust agreement, adoption agreement, recordkeeping, and other service provider contracts, initially and as amended.
- Investing plan assets or selecting investment vehicles from which participants may select their own investments in compliance with the investment policy statement.
- Recordkeeping—keeping track of participant accounts (money in; money out; handling distributions, including loans and withdrawals; and reflecting investment earnings) and asset custody.
- Reporting—filing annual Form 5500s with the US Department of Labor (and paying premiums to the Pension Benefit Guaranty Corporation if it's a DB plan).
- Annual discrimination and other compliance testing.
- Preparing and distributing participant communications that may include summary plan descriptions (needed initially for all types of plans), summary annual reports, enrollment materials, a summary of material modifications, annual fee disclosures, safe harbor notices (when matching contributions take the place of non-discrimination testing), automatic enrollment notices, tax notices, and qualified default investment alternative notices.
- Insurance—a fidelity bond is required, and fiduciary liability insurance is advisable.
- Determining eligibility to participate and interpreting other plan terms, including contribution limits, withdrawal provisions, and hardship and loan provisions.
- Determining how the Internal Revenue Code, and particularly it's qualification requirements, and ERISA apply in specific situations and to specific plan terms.
- Keeping track of beneficiary designations.
- Handling divorce orders that purport to divide a participant's plan benefits.
- Handling claims and appeals.
- Coordinating with payroll.

PLAN EXPENSES

Fiduciaries are required to ensure that fees paid out of the plan are reasonable. However, evaluating such fees can be difficult when, for example, services are bundled or revenues are shared. We cannot overemphasize the importance of this evaluation. Plan expenses (paid by the plan rather than by the employer) have become a hot spot in fiduciary litigation. For instance, fiduciaries have been faulted for not understanding the revenue sharing or not selecting the least expensive available share class.

- Answering participant questions.
- Auditing.
- Obtaining an actuarial valuation (DB only).
- Monitoring changes to the law requiring plan amendments and participant notification.

Decide how the company will staff those services. If the company does not have the resources or the expertise in house, we suggest hiring service providers. ERISA requires fiduciaries to have (or hire) the experience, knowledge, and expertise that the circumstances require.

6. SELECT AND CONTRACT WITH SERVICE PROVIDERS

Selecting a service provider is a fiduciary act requiring a documented due diligence process. RFPs may be developed (or other means of testing the market for the qualification, skills, experience needed) to establish that the fee the fiduciary negotiates is reasonable, given the scope of services provided. This obligation isn't extinguished when the contract is signed. Fiduciary responsibility requires ongoing monitoring of providers, reviewing of performance, and maintaining continued reasonableness of fees.

Agreements with service providers should be memorialized in contracts. The contract should describe the services to be provided in adequate detail (such as exactly what participant communications the vendor is responsible for preparing and distributing) and the fees. The employer should also negotiate terms, such as the standard of care, indemnifications, insurance, fee disclosure requirements, cybersecurity, and privacy standards. Vendor attempts to limit liability or require indemnification by the employer should be reviewed carefully. The plan itself is prohibited by law from indemnifying fiduciaries against the consequences of a fiduciary breach.

As discussed above, it's important for the contract to reflect the vendor's acknowledgment of any allocated fiduciary responsibility and a specific description of the duties constituting fiduciary duties. It's surprising, and generally ineffective, for a vendor hired to provide fiduciary activities to disclaim such responsibility.

7. INCORPORATE PLAN TERMS AND GOVERNING RULES INTO WRITTEN PLAN DOCUMENT

An ERISA plan must be in writing, and failure to operate the plan in accordance with its written terms is a fiduciary breach.[4] Fiduciaries should maintain copies and be familiar with the plan's terms. The plan document should detail exactly how the plan operates mechanically—vesting, participation, distributions, plan loans, etc.—and also provide specific guidance; for example, whether necessary and reasonable plan expenses may be paid by the plan or instead must be picked up by the employer. The plan's assets must be held in trust pursuant to a written trust agreement.

BEST PRACTICE

ERISA requires fiduciaries to have (or hire) the experience, knowledge, and expertise that the circumstances require.

8. FORMALLY ADOPT PLAN

Resolutions by a board of directors or other applicable employer governing body provide the authorization for a business to adopt the plan and for officers of the business to take actions required to implement the plan. Any adoption agreement must be signed by an authorized employer representative.

9. DEVELOP PROCEDURAL DOCUMENTS AS FURTHER GUIDANCE

A well-crafted investment policy statement, or IPS, sets out standards, processes, policies, and guidance on the investment of the plan's assets. The policy should also serve to confirm how responsibilities for selecting, monitoring, and managing plan investments are allocated. (For more in-depth discussion on the role of an IPS, see *"Straight Talk on Investment Policy Statements,"* at the end of this section.)

Day-to-day administrative procedural manuals or procedures setting out plan practices in administering specific programs, such as plan loans, hardship withdrawals, or qualified domestic relations orders, may also be helpful.

10. COMMUNICATE PLAN TO EMPLOYEES

A user-friendly summary plan description (SPD) is legally required (with penalties for non-compliance) and important for communicating to participants the terms of the plan in understandable language. Additional participant paperwork will be required to launch and operate the plan. Depending on the plan terms, that may include payroll authorization, beneficiary designations, and notices of automatic enrollment.

Summing It Up

Good fiduciary practice is based on foundational elements: a solid decision-making structure with well-developed policies and procedures in writing and adhered to with care. We will revisit many of these elements in greater detail later in this guide.

1. Section 404(a)(1)(B) of ERISA.
2. Section 406(a) and (b) of ERISA.
3. Section 404(a)(1)(D) of ERISA.
4. Section 404(a)(1)(D) of ERISA.

This guide was developed for Dimensional Fund Advisors LP ("Dimensional") principally by Ian S. Kopelman, a partner at DLA Piper LLP (US), and is intended solely to provide general guidance for plan sponsors and fiduciaries as well as investment and other retirement plan professionals. Information and opinions presented in this material have been obtained or derived from sources believed to be reliable; however, neither Dimensional Fund Advisors LP nor Mr. Kopelman represent that this information is accurate and complete, and it should not be relied upon as such.

Dimensional Fund Advisors LP and DLA Piper are separate, unaffiliated entities. Mr. Kopelman is an occasional speaker at events sponsored or hosted by Dimensional Fund Advisors LP.

Dimensional Fund Advisors LP is an investment advisor registered with the Securities and Exchange Commission.

The articles are distributed for informational purposes only and should not be considered investment, tax, or legal advice or an offer of any security for sale.

Dimensional does not endorse, recommend, or guarantee the services of any advisor, advisory, or consulting firm, nor any plan, person, or entity discussed herein.

Products may be mentioned or discussed that are not offered or sold by Dimensional Fund Advisors. Links to material hosted on another website are provided merely for convenience and do not imply any endorsement, representation, or warranty by Dimensional Fund Advisors with respect to any such linked website or the content, products, or services contained or accessible through such website or its operators. Linked sites are not under the control of Dimensional Fund Advisors, and Dimensional Fund Advisors is not responsible for the contents of any linked site or link contained in a linked site or any changes or updates to such site. Dimensional Fund Advisors disclaims responsibility for the privacy policies and customer information practices of any third-party website.

Investing involves risks. There is no guarantee investment strategies will be successful, and it is possible to lose money.

MKT-8783 12/20 1777948

Fiduciary Roles and Responsibilities

December 2020

Companies establish defined contribution (DC) plans to help employees save for retirement. This may sound simple; however, retirement plan management can be stunningly complex.

ERISA imposes heightened obligations, called fiduciary duties, on persons and entities that have certain responsibilities with respect to a plan. These ERISA fiduciaries are held to a high standard of conduct. ERISA fiduciaries must act solely in the interest of plan participants and beneficiaries, and exclusively for the purpose of providing benefits, while avoiding conflicts of interest and acts of self-dealing. Further, they are held to the "prudent expert" standard: fiduciaries must act with the care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

It has been argued that this standard[1] is even higher than that imposed on corporate officers and directors, who have the benefit of the business judgment rule. Individuals who breach their fiduciary duties can be personally liable for any losses caused under section 409 of ERISA. Fiduciaries can also be subject to statutory penalties under Part V of Title I of ERISA. Thus, a fiduciary's personal assets can be at risk in the event of a breach.

One way to help with these challenges—and provide additional expertise in connection with plan investments, operations, and administration—is to retain the assistance of third-party firms with the appropriate licensing, experience, technology, and bandwidth to perform various functions, such as recordkeeping, investment management, and/or advice and claims administration. When retaining third-party firms, an issue to consider is whether and how much fiduciary responsibility (and thus risk) can be transferred in obtaining these necessary services.

Who are a plan's fiduciaries? The answer is not always obvious because the ERISA fiduciary definition looks beyond title to include functional concepts of control and authority. Persons with certain titles are always fiduciaries—named fiduciaries, trustees, and plan administrators by the nature of their duties are fiduciaries, as are appointed investment managers.

Developed for Dimensional Fund Advisors by Ian S. Kopelman, partner at DLA Piper.

In determining whether the exercise of specific authority or actions will result in an individual or entity becoming a fiduciary, section 3(21) of ERISA provides that a person or entity is a fiduciary with respect to a plan to the extent any of the following apply:

i) he or she exercises any discretionary authority or discretionary control respecting management of a plan or exercises any authority or control, whether discretionary or not, respecting management or disposition of its assets.

ii) he or she renders investment advice for a fee or other consideration, direct or indirect, with respect to any money or other property of such plan, or has any authority or responsibility to do so.

iii) he or she has any discretionary authority or discretionary responsibility in the administration of such plan.

The implication: in addition to the persons who are always fiduciaries by virtue of their title, whether others are fiduciaries depends on their having or exercising the requisite authority and control as defined in section 3(21) (regardless of contract language disavowing any fiduciary status!).

How are fiduciaries designated? Under section 402 of ERISA, each plan must provide for one or more "named fiduciaries." These fiduciaries must be either named in the plan document or identified as a fiduciary by the plan sponsor (typically the employer) pursuant to a procedure specified in the plan. The named fiduciaries have authority to control and manage the operation and administration of the plan. The fiduciary named in the plan can be the plan sponsor, but the US Department of Labor (DOL) suggests that, in such a case, the plan document should also provide for the designation by the sponsor of specified individuals or others to carry out specified responsibilities.

Under section 405(c) of ERISA, a plan may expressly provide procedures for allocating fiduciary responsibilities. As a general rule, if those procedures are followed, the named fiduciary will not be responsible for the actions of fiduciaries to whom fiduciary responsibility has been properly allocated or delegated, unless the named fiduciary, through action or inaction, knew or should have known the appointed fiduciary was or had committed a fiduciary breach and failed to take steps to correct.

Appointing a fiduciary is itself a fiduciary act—the appointing person must prudently select the appointed fiduciary and monitor that appointment to confirm that it remains prudent over time. This rule requires oversight and periodic review of the appointed fiduciary's performance. In addition, as noted above, the appointing fiduciary has co-fiduciary responsibility under section 405 of ERISA, which provides in part that a fiduciary is responsible for the actions of a co-fiduciary to the extent the fiduciary knew or should have known that the actions of the co-fiduciary constituted a breach and failed to take steps to correct.

Service providers vary in the degree of fiduciary responsibility they will accept, and plan sponsors or other named fiduciaries vary in their in-house capacities and interests in delegating fiduciary responsibility. Thus, the key is to attain the matchup of services and responsibility desired, and then to exercise vigorous oversight to ensure that the appointee is exercising its responsibilities appropriately.

A plan's named fiduciary may decide to retain a third-party administrator (TPA) to essentially assume responsibility for the "first line" administration of the plan, with or without discretionary control over the plan's operations and administration. A TPA can be delegated fiduciary responsibility as long as the plan documents provide for such a delegation and the plan document delegation procedures are followed. The contract with the administrator should include the TPA's acknowledgment of fiduciary status if, in fact, discretionary authority or control is being delegated. The plan sponsor or other appointing fiduciary remains responsible for selecting that TPA and continuing to monitor its performance to determine that the appointment remains prudent (including, to the extent fees are being paid out of the plan, initial and ongoing evaluation that the fees charged are reasonable). The plan sponsor or other appointing fiduciary is, theoretically, not responsible for the TPA's actions. After selection, however, the appointing fiduciary retains the ongoing oversight responsibilities as well as the co-fiduciary responsibilities described above.

A TPA can be retained to perform some but not all fiduciary tasks. Alternatively, the TPA could perform no fiduciary tasks at all but merely ministerial tasks, working under rules, policies, and procedures established by the plan sponsor or other named fiduciary that do not involve discretionary decision making or any management or control over plan assets. The contract with the TPA should clearly reflect the parties' understanding of the relationship and the services to be provided. However, since the definition of a fiduciary is functional in nature, a service provider who in fact exercises fiduciary authority is a fiduciary regardless of any contrary contract terms. At the same time, the provider's fiduciary status does not relieve the appointing fiduciary of responsibility for the service provider's duties unless that responsibility was properly delegated and appropriate oversight has been maintained.

For assistance with managing a plan's investments, the plan sponsor or other named fiduciary can similarly appoint investment managers and/or advisors with varying levels of responsibility. But the plan sponsor or other named fiduciary should delegate fiduciary responsibility over plan assets to a third party only by appointing an investment manager in accordance with section 3(38) of ERISA. Under the provision, the manager must be an investment advisor registered under the Investment Advisers Act of 1940, a bank, or an insurance company that acknowledges in writing that it is a fiduciary with respect to the plan.

By retaining an investment manager in accordance with section 3(38), the plan sponsor or other named fiduciary can effectively shift some, but not all, fiduciary liability to that

investment manager. The manager can be given complete discretionary authority (i.e., complete fiduciary responsibility) to manage the plan's investments, or the appointing fiduciary can retain whatever investment authority (with full investment responsibility) it wishes as provided for in the service agreement. The appointing fiduciary is not then, theoretically, responsible for decisions made by the investment manager appointed under section 3(38) of ERISA. However, in all cases, the plan sponsor or other named fiduciary that appointed the 3(38) remains responsible/liable for the proper selection of that investment manager fiduciary and continued monitoring to determine that its continued engagement remains appropriate.

Of course, an investment advisor may be appointed to do ministerial acts, such as preparing diligence reports without recommendation, in which case the provider will not ordinarily function as a fiduciary. Or an advisor may be retained and paid to recommend investment options, monitor investments, and suggest replacements or advise on investment policy. But unless that advisor is appointed as a 3(38) investment manager, the plan sponsor, investment committee, or other named fiduciary retains responsibility for the actual investment decisions. In any event, the responsibility to prudently select and periodically determine to continue to retain the investment manager or advisor remains an obligation of the appointing fiduciary.

The Promise Anew of MEPs

Participation in a multiple employer plan (MEP) may provide an opportunity to outsource much of the administrative burdens and fiduciary responsibility. MEPs may be particularly attractive to smaller employers, which often do not have the same capacities as larger companies and may not be as wedded to unique plan features. MEPs are not a new concept, but until recently, federal regulation has limited the availability and attractiveness of this solution.

With the passage of the Setting Every Community Up for Retirement Enhancement (SECURE) Act in December 2019, a new kind of MEP will be possible starting in 2021. For the first time, providers (pooled plan providers) that register with the Treasury Department may offer this new type of "open" MEP to totally unrelated employers. These providers can be different kinds of firms, such as insurance companies, banks, trust companies, consulting firms, recordkeepers, or third-party administrators. The pooled provider would have to be designated in the plan documents as the named fiduciary, the plan administrator, and the person responsible for performing all administrative duties reasonably necessary for the operation and administration of the plan. The plan document will also have to designate one or more trustees to be responsible for collecting contributions to and holding the assets of the plan.

The use of MEPs and pooled employer plans (PEPs) can result in participating employers being significantly relieved of the fiduciary responsibilities, as well as much of the administrative burden, and associated costs of plan operation and administration. The SECURE Act provides that the employer would retain fiduciary responsibility for selecting and monitoring the provider and any other person designated as a named

fiduciary of the plan and also retain responsibility for the investment and management of the portion of the plans' assets attributable to its employee participants, unless those responsibilities have also been delegated to another fiduciary by the provider.

The SECURE Act directs the DOL (and the Treasury Department) to issue guidance for implementing this new kind of MEP. DOL guidance will likely be important to defining the scope of fiduciary liability retained by the employer as will the fiduciary structures required to be developed by the firms gearing up to become pooled plan providers. For example, will these firms delegate responsibility for investment and management of all plan assets so that the employer has only an oversight responsibility for plan investments as well as the other plan management functions?

This MEP legislation is a promising development, potentially providing an option for plan sponsors seeking a less expensive, less burdensome, and, from a legal perspective, a less risky way to help their employees save for retirement.

1. The ERISA standard of care is the "the highest known to the law." [Donovan v. Bierwirth, 680 F.2d 263, 272 n.8 (2d Cir.).]

This guide was developed for Dimensional Fund Advisors LP ("Dimensional") principally by Ian S. Kopelman, a partner at DLA Piper LLP (US), and is intended solely to provide general guidance for plan sponsors and fiduciaries as well as investment and other retirement plan professionals. Information and opinions presented in this material have been obtained or derived from sources believed to be reliable; however, neither Dimensional Fund Advisors LP nor Mr. Kopelman represent that this information is accurate and complete, and it should not be relied upon as such.

Dimensional Fund Advisors LP and DLA Piper are separate, unaffiliated entities. Mr. Kopelman is an occasional speaker at events sponsored or hosted by Dimensional Fund Advisors LP.

Dimensional Fund Advisors LP is an investment advisor registered with the Securities and Exchange Commission.

The articles are distributed for informational purposes only and should not be considered investment, tax, or legal advice or an offer of any security for sale.

Dimensional does not endorse, recommend, or guarantee the services of any advisor, advisory, or consulting firm, nor any plan, person, or entity discussed herein.

Products may be mentioned or discussed that are not offered or sold by Dimensional Fund Advisors. Links to material hosted on another website are provided merely for convenience and do not imply any endorsement, representation, or warranty by Dimensional Fund Advisors with respect to any such linked website or the content, products, or services contained or accessible through such website or its operators. Linked sites are not under the control of Dimensional Fund Advisors, and Dimensional Fund Advisors is not responsible for the contents of any linked site or link contained in a linked site or any changes or updates to such site. Dimensional Fund Advisors disclaims responsibility for the privacy policies and customer information practices of any third-party website.

Investing involves risks. There is no guarantee investment strategies will be successful, and it is possible to lose money.

MKT-8783 12/20 1777948

Use of Committees for Retirement Plan Governance

December 2020

KEY PRINCIPLE

The organization that establishes a plan is responsible for its management to the extent that responsibility is not properly delegated to others, and plan sponsors are commonly advised to use plan committees to exercise plan management and investment functions.

Who is responsible for the decisions required in connection with plan operations and administration and the investment of plan assets, and how are they actually made? Answering these questions clearly and effectively is a key to streamlining plan management and isolating fiduciary risk.

The organization that establishes a plan (the plan sponsor) is responsible for its management to the extent that responsibility is not properly delegated to others. This means the buck stops with an organization's board of directors, members, or partners for all plan management, unless specific responsibilities are properly delegated.

Responsibilities may be delegated to third-party service providers, one or more committees, or specific individuals designated by name or title. For example, responsibility for setting up and maintaining the available investment choices (or for the day-to-day administration of the plan) can be delegated to a committee or committees or one or more individuals, rather than borne directly by the plan sponsor's full board of directors, though the board or other appointing entity remains responsible for monitoring its appointments.

Plan sponsors are commonly advised to use plan committees to exercise plan management and investment functions. However, each plan sponsor must determine if a committee is the best choice for all or certain aspects of plan management. If so, what's the best way to build a committee that works well? In addition, if a committee structure is selected, the plan sponsor must typically determine the committee members. The answers depend on the size and complexity of the organization and its plan, in-house resources, and human factors affecting committee dynamics.

A Legal Perspective (Nuts and Bolts on Plan Committees)

ONE OR MORE COMMITTEES?

The plan sponsor may decide that a single plan committee is most efficient or that multiple committees are warranted (see **Exhibit 1**, next page). With multiple committees, one may handle investments and another administration, for example. A separate committee may be appointed to hear only benefit appeals. Specialized committees reduce their members' responsibility (with potential liability) for the fiduciary functions outside of their purview.

Developed for Dimensional Fund Advisors by Ian S. Kopelman, partner at DLA Piper.

Exhibit 1: **Committee Structure**

Source: "DC Observer," Callan Institute (Third Quarter 2017).

A slight majority of plan sponsors maintain a single committee to monitor and manage their defined contribution (DC) programs, according to a 2017 survey.[1]

Establishing the Committee(s) with a Guiding Roadmap (Investment Policy Statement or Charter)

A committee must be formally established by the plan sponsor or a named fiduciary pursuant to a procedure contained in the plan document. The appointing authority may wish to accomplish the following in establishing or implementing a committee:

- Appoint committee members (by title or individual name).
  - Consider background, experience, expertise needed.
  - Designate one member as chair.
  - Designate a secretary to ensure minutes are taken and maintained.
  - Decide on optimal size.
- Grant specified authority. Is the committee merely advisory or authorized to, e.g., amend the plan, retain advisors, or appoint an investment manager? The committee may more generally be authorized to exercise any power within the authority of, and delegated to it by, the board of directors of the plan sponsor.
- Describe the committee's purpose and duties, which is often done in a committee charter, or incorporated in an investment policy statement in the case of an investment committee.
- Specify how the committee is to operate. For example, are decisions made by majority vote, the frequency of meetings, the keeping of minutes, or requirements for monitoring investments (unless that level of specificity is left to the committee to fashion)?
- Adopt some or all necessary plan amendments, or is that responsibility being retained by the governing body of the plan sponsor?
- Indemnify the in-house committee members by the plan sponsor (or the plan), and consider or review the additional need for fiduciary liability insurance.

PRO TIP

A committee must be formally established by the plan sponsor or a named fiduciary pursuant to a procedure contained in the plan document, and great care should be taken to minimize group bias in decision making.

Mechanics of Operating the Committee(s)

- Meet regularly, and more often as needed, to carry out responsibilities with prudence and diligence and in accordance with any regularity specified by the charter or investment policy, but typically at least quarterly. However, there is no magic number.
- Maintain a mechanism for communicating between meetings or holding special meetings if circumstances warrant.
- Chair and run meetings and observe voting rules as specified in the charter or investment policy (or as determined by the committee itself).
- Send advance agendas with reports for committee member review—for example, the investment consultants' report on each investment fund's performance, benchmarking, market analyses, and asset allocation reviews.
- Keep, adopt, and maintain minutes. They should include the date and time of meetings, committee members present, topics discussed, decisions made and the bases for those decisions, and all reports distributed in advance or at the meeting. (Recall the importance of demonstrating the prudent process that fiduciaries undertake in reaching a decision. Minutes can be the fiduciary defendants' best defense against a claim of fiduciary breach.) The committee should adopt completed minutes at subsequent meetings and have a system in place for their maintenance and preservation.

A Sampling of Duties

Duties will largely flow from a charter or investment policy and from the committee members' understanding of their fiduciary obligations. Some general examples:

ALL PLAN COMMITTEES

- To carry out their duties, committee members must first understand the fiduciary duties imposed by ERISA:
  - Committee members must be familiar with applicable provisions of the governing plan, trust, and other documents.
  - Committee members **should** be trained on ERISA fiduciary duties when initially appointed and then periodically. (For more information on industry training and certification courses, please see "Fiduciary Education, Training, and Certification Resources" in Appendix.)
  - Committee members should, if needed, educate themselves on the substantive aspect of the committee's work—plan investment or administration. A committee may hire professional advisors but must first investigate those professionals' qualifications and provide them with complete and accurate information. If professional advisors are appointed, committee members need to know enough to ask good questions so they can evaluate the professional advice received. The committee must also periodically go through a process to compile and evaluate information necessary to enable it to determine whether it is prudent for the advisor to continue to be retained. Committee members "may not unthinkingly defer to a professional advisor's

expertise" but must "meaningfully probe" the advisor's recommendations and "make informed but independent decisions."[2] In the case of receiving and acting in advice, the buck stops with the advisee.

  - Document all training provided, including committee member attendance at seminars or other educational opportunities.

- In addition to the fiduciary duties of loyalty and prudence, ERISA specifically mandates that fees paid by a plan (but not by the plan sponsor) be no more than reasonable. Because of the impact of fees paid by the plan on returns and thus retirement savings available to employees (and because plan fees are so often targeted in litigation), committees should pay particular attention to plan expenses:
  - Monitor all service providers receiving direct or indirect compensation from the plan. Follow documented processes to evaluate the quality of services and pricing, with periodic benchmarking or requests for proposal.
  - Fully understand all fees payable in connection with the plan, which may involve bundled service fees, revenue sharing offsets, rebates, or other arrangements requiring a probing analysis. If a service provider receives any fees from the plan understand and evaluate all fees paid to the service provider, including those from sources other than the plan.
  - Understand the services promised—for example, if a provider is to serve in a fiduciary capacity, such as deciding appeals, is that contractually acknowledged? Is the provider adequately insured?
- Report regularly to the appointing entity (the appointing board of directors or other entity is responsible for monitoring its appointments).

Other duties are specific to the nature of the committee's work. Some examples:

INVESTMENT COMMITTEE

- Review investment offerings for continued alignment with the investment policy statement.
- Monitor investment performance against benchmarks.
- Monitor asset allocation.
- Keep and revisit a watch list of investments that may require changes.
- Periodically consider alternatives to current offerings in terms of share classes, use of collective investment trusts, or other alternatives to mutual funds, etc.
- Document deliberations and reasons for making changes.
- Meet with the firms providing services and investments.

BEST PRACTICE

Fees paid by the plan can impact returns (and thus retirement savings available to employees), so committees should pay particular attention to plan expenses because plan fees are so often targeted in litigation.

ADMINISTRATIVE COMMITTEE

- Review plan status and relevant metrics to understand whether the plan in operation continues to meet the company's goals.
- Review for proper plan documentation—all plan documents, amendments, adoption agreements, participation agreements, board resolutions, and contracts should be properly signed.
- Review plan compliance. Know who is responsible for periodically monitoring for:
  - Current compliance with legislative and regulatory changes.
  - Annual regulatory and compliance testing.
  - Timely deposit of contributions to trust.
  - Assurance that internal procedures and controls are working so plan and IRS rules on, e.g., contribution limits, required minimum distributions, hardship withdrawals, loans, or qualified domestic relations orders (QDROs), are operating correctly.
  - Assurance that plan reporting (including Form 5500s) and disclosures (such as summary plan descriptions and a summary of material modifications) are distributed in a timely and accurate fashion.
  - Assurance that claims and appeal procedures are in place and operational.
  - Periodic review of plan administration, i.e., that benefit payments, contributions, and claims are being handled expeditiously and cost-effectively.

Committee dynamics can be challenging when managing a retirement plan. For more on this topic, please see *"Is Group Decision Making Really a Good Idea?"* by behavioral economist Warren Cormier on the next page.

1. DC Plan Governance Survey, conducted by Callan in May 2017, gathered responses from 106 institutions (57% corporations, 22% public agencies, and 22% tax-exempt organizations).
2. Sacerdote v. New York University, 328 F. Supp.3d 273, 287 (SDNY 2018).

A Behavioral Economist's Perspective: Is Group Decision Making Really a Good Idea?

By **Warren Cormier**
Executive Director Emeritus,
DCIIA Retirement Research Center

Many decisions regarding defined contribution (DC) plan operation and investment menu selection and monitoring are made using groups, typically designated as committees. The fundamental question is whether using a group to make a decision results in the optimal outcome for participants.

Do group dynamics get in the way of making the best decisions? Behavioral economics has something to say about this question. Most people would say that we all possess at least some cognitive flaws, some more serious than others. Therefore, when we form a group, the issue of biased decision making is not a question of "if?" but rather "how much?"

What Causes Suboptimal Decisions?

Group bias in decision making can be minimized (or at least recognized) by understanding its root cause(s). Below are the fundamental reasons why groups may make suboptimal decisions:

INCORRECT CO-ORIENTATION

Co-orientation refers to the ability of a decision-making group to understand the needs and preferences of the people affected by group decisions. These decisions are typically intended to benefit another group, such as participants in the case of a DC plan. Our research at Boston Research Technologies has shown that decision-making groups frequently do not fully understand the group for whom they are making decisions.

A typical example of incorrect orientation surrounds the preferences of DC participants regarding the characteristics of the investments they choose. An immediate first step—which is rarely taken—is surveying the needs and preferences of the people affected by the decisions. Instead, group members often make decisions based on what they perceive the target audience wants, needs, and prefers—a potentially dangerous practice.

LOSS AVERSION

Loss aversion is the phenomenon identified by Daniel Kahneman in his Nobel Prize-winning work on prospect theory.[1] Simply stated, people are more negatively impacted psychologically by a loss than they are positively impacted by a gain of an equal amount.

REGRET AVOIDANCE

Closely tied to loss aversion is regret avoidance: people change their behaviors to avoid feeling regret in the future. These dynamics collectively affect decision-making groups (which obviously consist of human beings). Consequently, group members need to frequently assess whether they are making the right decision or the safe decision, which may not be the most beneficial one for the people affected by the decision.

Most Common (and Most Dangerous) Forms of Group Bias

OVERCONFIDENCE

Citing Nobel laureate Daniel Kahneman again, overconfidence is perhaps the most dangerous of the multitude of cognitive biases at work among people individually and in groups. Specifically, people have a tendency to overestimate their own skills and predictions for success.

The space shuttle Challenger disaster is a classic example of bad group decision making caused by overconfidence. Historical data show that booster rockets have a failure rate of one in every 57 launches. NASA set the probability rate at one failure in every 100,000 launches. To put this into perspective, if a space shuttle were launched every day, NASA's estimate implies that there would be only one failure in 275 years.

In addition, NASA's hierarchical corporate structure reduced the likelihood that lower-ranked engineers would express concerns. In other words, there was overconfidence that the highest-ranking engineers would make the best decisions.

Possible solutions? Reframing questions to a group can be helpful in neutralizing overconfidence. For example, the Challenger decision rule was framed as, "Can you prove it's unsafe to launch?" Reversing the framing—"Can you prove it's safe to launch?"—may have averted the disaster.

The space shuttle Challenger disaster is a classic example of bad group decision making caused by overconfidence.

POLARIZATION

Another form of group bias is sometimes negatively referred to as "mob rule." Harvard Law School Professor Cass R. Sunstein[2] describes it this way:

> *"From decades of empirical research, we know that when like-minded people speak with one another, they tend to become more extreme, more confident, and more unified."*

We frequently see the practice when groups are formed using an unspoken rule that people who have contrary views should be excluded: "Don't invite her into the group, as she never agrees with us."

CONFORMITY

Conformity is a common form of group bias and can have severe negative effects. Simply stated, many people go along with the group regardless of what they themselves might think as individuals.

Remedies? Although group bias can never be eliminated, these strategies may help reduce it:

- Diverse disciplines. When a group is created, extra effort should be given to ensuring that people from various disciplines with a variety of points of view are included to overcome polarization and conformity.
- Hierarchy. Assess whether a hierarchical culture in the organization (and thus in the group) limits discussion. Be ruthlessly honest about whether it is safe for junior members to contradict the more senior members.
- Group size. Increasing the number of people in a group does not ensure better outcomes. The optimal size is approximately four to six "highly engaged" people. Larger groups may run the risk of people disappearing in the crowd.
- Decision-making tactics (public/private). Asking members to vote publicly can exacerbate the problems of conformity. Allowing members to register their votes privately goes a long way toward reducing the problem.
- Devil's advocate. Having a devil's advocate on the team can be helpful in reducing polarization. Devil's advocates force group members to test their own assumptions and conclusions.
- Leadership style. The leader should ensure that all members are actively participating in the deliberations and not allow anyone to disappear into the crowd.
- Outside experts. To help neutralize overconfidence, polarization, and conformity, invite experts from outside the immediate group or even outside the corporation to provide objective information and viewpoints.
- Reframe the question to be answered. "Choice architecture" refers to the idea that the way questions are asked can significantly change the outcome. Reframing questions to a group can be helpful in neutralizing overconfidence. Remember, the Challenger decision rule was framed as, "Can you prove it's unsafe to launch?" Reversing the framing—"Can you prove it's safe to launch?"—may have averted the disaster.

1. Deborah Smith, "Psychologist Wins Nobel Prize," American Psychological Association, December 2002.
2. Cass R. Sunstein, "Shutdown Psychology Made Simple," Bloomberg Opinion, October 2013.

This guide was developed for Dimensional Fund Advisors LP ("Dimensional") principally by Ian S. Kopelman, a partner at DLA Piper LLP (US), and is intended solely to provide general guidance for plan sponsors and fiduciaries as well as investment and other retirement plan professionals. Information and opinions presented in this material have been obtained or derived from sources believed to be reliable; however, neither Dimensional Fund Advisors LP nor Mr. Kopelman represent that this information is accurate and complete, and it should not be relied upon as such.

Dimensional Fund Advisors LP and DLA Piper are separate, unaffiliated entities. Mr. Kopelman is an occasional speaker at events sponsored or hosted by Dimensional Fund Advisors LP.

Dimensional Fund Advisors LP is an investment advisor registered with the Securities and Exchange Commission.

The articles are distributed for informational purposes only and should not be considered investment, tax, or legal advice or an offer of any security for sale.

Dimensional does not endorse, recommend, or guarantee the services of any advisor, advisory, or consulting firm, nor any plan, person, or entity discussed herein.

Products may be mentioned or discussed that are not offered or sold by Dimensional Fund Advisors. Links to material hosted on another website are provided merely for convenience and do not imply any endorsement, representation, or warranty by Dimensional Fund Advisors with respect to any such linked website or the content, products, or services contained or accessible through such website or its operators. Linked sites are not under the control of Dimensional Fund Advisors, and Dimensional Fund Advisors is not responsible for the contents of any linked site or link contained in a linked site or any changes or updates to such site. Dimensional Fund Advisors disclaims responsibility for the privacy policies and customer information practices of any third-party website.

Investing involves risks. There is no guarantee investment strategies will be successful, and it is possible to lose money.

MKT-8783 12/20 1777948

Fiduciary Education

December 2020

KEY PRINCIPLE

Fiduciaries must educate themselves to perform as well as expected and required. Education and training are essential–not only to prepare and stay adequately prepared for demanding duties, but to demonstrate the fiduciary's prudent approach to understanding and exercising those duties.

Auditors for the US Department of Labor (DOL) are increasingly asking whether retirement plan committee members receive fiduciary training—and when the fiduciary training was *last done*.

As we have stressed throughout this guide, persons who are fiduciaries with respect to ERISA retirement plans have important and often complicated duties and are held to the highest legal standards in carrying them out. So it is not surprising that DOL auditors see fiduciary training as a necessity and that it should be conducted periodically for all fiduciaries rather than only during an introductory session for new committee members.

Fiduciaries must educate themselves to perform as well as expected and required. Education and training are essential—not only to prepare and stay adequately prepared for demanding duties, but to demonstrate the fiduciary's prudent approach to understanding and exercising those duties. Finally, documenting all fiduciary education activities that are undertaken is a best practice.

Items to Consider

Keeping in mind that the experience level and sophistication of persons serving as fiduciaries vary widely, proper education and training programs should be tailored to plan size and other circumstances, such as fiduciary expertise. The following are some general suggestions.

1. IDENTIFICATION OF FIDUCIARIES

Everyone serving in a fiduciary capacity, whether on a committee or by virtue of his or her position or job responsibilities, must understand their status. Training could include talking to everyone working with the plan and determining who is working in a fiduciary capacity. Each fiduciary should also be able to identify other plan fiduciaries, understand the plan's fiduciary structure and their co-fiduciary responsibilities, and grasp what steps they should take to ensure their compliance with these requirements.

2. DEEP KNOWLEDGE OF THE NATURE OF A FIDUCIARY'S DUTIES

Like a government official with a pocket US Constitution, plan fiduciaries should retain a copy of the ERISA legislation and should read through the basic fiduciary duties regularly to refresh their knowledge and understanding of each fiduciary's primary duties and to whom those duties are owed. Education should also reinforce the

requirement that fiduciaries act solely in the interest of the plan participants and not in the interest of the employer, and that fiduciaries must act with the care, skill, prudence, and diligence of a person acting in similar circumstances and familiar with such matters.

3. PERIODIC REVIEW OF LEGISLATIVE CHANGES, REGULATORY INTERPRETATIONS, AND COURT DECISIONS

Fiduciaries should keep up to date with legislative and regulatory changes that may impact their roles. In addition, it's invaluable to review ERISA fiduciary cases to understand how a judge may characterize a fiduciary's well-intentioned actions. A review of cases on current, particularly troublesome issues—such as excessive fees or poor investment performance—is also recommended. Such reviews can involve attendance at seminars and webinars as well as periodic earmarked training sessions conducted by the plan's ERISA counsel or other ERISA professional.

4. FAMILIARITY WITH GOVERNING PLAN DOCUMENTS

Among a fiduciary's responsibilities is to act in accordance with the documents under which a plan is established and maintained. These documents include the plan document itself, the trust agreement, any insurance policies, any underlining collective bargaining agreements, and plan committee charters, investment policy statements, and delegation resolutions. Relevant fiduciaries should also be familiar with how the plan is communicated to participants, and these fiduciaries should read the summary plan description and communications on fee disclosures and investment options. Remember, the first question a plaintiff's attorney or the DOL is likely to ask is, "Have you read the plan document?"

5. KNOWLEDGE ABOUT FEES

Know what fees and expenses the plan is paying directly and indirectly and who is getting various fees. For example, what are the recordkeeper and investment managers receiving from the plan and other sources for work performed for the plan? Compare these fees with benchmarking data. Periodically review and affirm fiduciary choices that affect fees, such as the share class purchased when investing in a publicly traded mutual fund. Also, fiduciaries need to understand and be able to explain why the committee chose active funds instead of index funds or mutual funds instead of collective investment trusts, which often have lower fees. Some fiduciaries have the expertise to understand how to make these decisions on their own, but many need information and education about the creation of a solid process and the evaluation of appropriate variables that enable them to arrive at reasonable and defensible decisions.

6. KNOWLEDGE ABOUT THE SUBJECT MATTER

Members of an investment committee, for example, must adequately educate themselves on investments to be able to intelligently and prudently evaluate the recommendations of investment advisors and ask probing questions. It is not adequate for a fiduciary to reflexively accept recommendations. Similarly, an administrative fiduciary must maintain expertise in areas impacting their role, e.g., cybersecurity, the constantly evolving area of relative fees charged by various potential service providers, and employee communications. Fiduciaries must know when expert advice should be obtained.

BEST PRACTICES

- Each fiduciary should be able to identify other plan fiduciaries, understand the plan's fiduciary structure and their co-fiduciary responsibilities, and grasp what steps they should take to ensure their compliance with these requirements.
- Fiduciaries should keep up to date with legislative and regulatory changes that may impact their roles.
- If a fiduciary does not possess the appropriate knowledge on ERISA and have the ability to monitor the ever-changing regulatory landscape, it is wise to consider engaging an education or certification provider.

7. EDUCATING AND TRAINING ON SPECIFIC RESPONSIBILITIES:

- Developing and following investment policy
- How to select, monitor, and evaluate service providers
- Due diligence in selecting and monitoring investment options and providers
- Contracting with service providers
- Deposit of deferrals
- What to do in case of conflicts

8. INDUSTRY TRAINING AND CERTIFICATION

Plan sponsors maintain the internal subject matter expertise in ERISA to train themselves on the relevant rules and responsibilities covering their duties. If a fiduciary does not possess the appropriate knowledge on ERISA and have the ability to monitor the ever-changing regulatory landscape, it may be wise to consider engaging an education or certification provider. See the Appendix for an abbreviated list of industry training and certification providers.

PRO TIP

Plan fiduciaries should retain a copy of the ERISA legislation and should read through the basic fiduciary duties regularly to refresh their knowledge and understanding of each fiduciary's primary duties and to whom those duties are owed.

This guide was developed for Dimensional Fund Advisors LP ("Dimensional") principally by Ian S. Kopelman, a partner at DLA Piper LLP (US), and is intended solely to provide general guidance for plan sponsors and fiduciaries as well as investment and other retirement plan professionals. Information and opinions presented in this material have been obtained or derived from sources believed to be reliable; however, neither Dimensional Fund Advisors LP nor Mr. Kopelman represent that this information is accurate and complete, and it should not be relied upon as such.

Dimensional Fund Advisors LP and DLA Piper are separate, unaffiliated entities. Mr. Kopelman is an occasional speaker at events sponsored or hosted by Dimensional Fund Advisors LP.

Dimensional Fund Advisors LP is an investment advisor registered with the Securities and Exchange Commission.

The articles are distributed for informational purposes only and should not be considered investment, tax, or legal advice or an offer of any security for sale.

Dimensional does not endorse, recommend, or guarantee the services of any advisor, advisory, or consulting firm, nor any plan, person, or entity discussed herein.

Products may be mentioned or discussed that are not offered or sold by Dimensional Fund Advisors. Links to material hosted on another website are provided merely for convenience and do not imply any endorsement, representation, or warranty by Dimensional Fund Advisors with respect to any such linked website or the content, products, or services contained or accessible through such website or its operators. Linked sites are not under the control of Dimensional Fund Advisors, and Dimensional Fund Advisors is not responsible for the contents of any linked site or link contained in a linked site or any changes or updates to such site. Dimensional Fund Advisors disclaims responsibility for the privacy policies and customer information practices of any third-party website.

Investing involves risks. There is no guarantee investment strategies will be successful, and it is possible to lose money.

MKT-8783 12/20 1777948

Straight Talk on Investment Policy Statements

December 2020

"Fiduciary" is a term derived from the Latin word *fiduciarius*, which means to "hold in trust." Plan sponsors, and their service providers that accept the role of fiduciary, are required to "hold in trust" (or safeguard) retirement plan assets and act exclusively in the interest of plan participants.

A well-crafted investment policy statement (IPS) will lay out a clear set of procedures for following a prudent fiduciary process (for an explanation of this process, see "*Fiduciary Roles and Responsibilities*" earlier in this section). The IPS will also provide a practical set of guidelines for committee members as they carry out their oversight and governance duties on an ongoing basis. In this sense, the IPS will function as a reference document, and if desired, it can incorporate the charter to define the committee's structure and the roles and responsibilities of its members.

KEY PRINCIPLE

IPS documents can help plan fiduciaries satisfy their responsibilities under ERISA, but these documents must be carefully drafted to provide flexibility so that they are not used by potential plaintiffs as a justification for alleging a breach of fiduciary responsibility.

Keep in mind that the Employee Retirement Income Security Act of 1974 (ERISA) does not explicitly require that each employee benefit plan maintain an IPS or that it is written. Instead, the concept arises out of the fiduciary duty of prudence that applies under both ERISA and the common law of trusts and is referred to in US Department of Labor (DOL) interpretive bulletins (see Interpretive Bulletin 94-2). In fact, a copy of the plan's IPS is usually requested as part of any DOL plan audit.

Although IPS documents can help plan fiduciaries satisfy their responsibilities under ERISA, the documents must be carefully drafted and followed to ensure that they are not used by potential plaintiffs as a justification for alleging a breach of fiduciary responsibility. Once written, investment policy statements become part of the documents and instruments under which the plan is established and maintained and thus must be followed [see ERISA section 404(a)(1)(D)]. For example, in *Tussey v. ABB, Inc.*, a Missouri federal district court held that 401(k) plan fiduciaries were liable for more than $35 million in plan losses resulting from excessive fees due to a fiduciary breach that resulted in large part from the failure to follow the plan's IPS. (The history of this 2006 case includes two appeals court rulings ending with a reported $55 million settlement in 2019.[1]) Thus, failure to follow an IPS, once adopted, could be considered a clear demonstration of the fiduciary's imprudence and therefore a violation of ERISA.

Developed for Dimensional Fund Advisors by Ian S. Kopelman, partner at DLA Piper.

A properly drafted IPS will generally include the following:

- Purpose statement with general investment objectives for the plan.
- Confirmation of fiduciary structure, including detail of delegation or allocation of responsibilities.
- Standards and guidelines for meeting those investment objectives.
- Process or mechanism for selecting plan investments and monitoring investment performance.
- Statement of intent to comply with section 404(c) relating to participant's investment choices, if applicable.
- Statement of intent to comply with qualified default investment alternative (QDIA), if applicable.
- Processes for oversight of service providers, including periodic service and fee benchmarking.

As evidenced by *Tussey*, a fiduciary who ignores and/or violates the plan's investment policy statement doesn't get any protection at all, or worse, may be deemed to have committed a breach solely because the IPS was not followed. For this reason, many practitioners recommend that an investment policy statement at least contain the minimal standards that will enable plan fiduciaries to demonstrate compliance with their prudence and other ERISA requirements while leaving more stringent standards and processes to be put into effect informally.

An IPS should, therefore, be written in such a way that the committee members have enough structure and direction to fulfill their duties but also be broad enough to provide flexibility as they make specific decisions. Plan sponsors and committees may mitigate certain risks (including claims of a fiduciary breach) by avoiding common pitfalls, which include:

1. Incorporating excessively restrictive language with respect to general policies and investment monitoring.
2. Failing to follow the policies of the IPS.

In the case of investment monitoring, the IPS may provide the committee enough latitude to review multiple factors when determining if an investment fund should be replaced, rather than requiring action based on a single metric that could otherwise result in the fiduciary falling out of compliance with the IPS.

In most cases, plan fiduciaries will be judged on whether their process supports their actions rather than the actual outcome of their decisions. Clearly defining a process framework with the appropriate documentation for decision making and execution is critical. A well-drafted IPS that is consistently followed provides confidence for plan fiduciaries and substantiates that a prudent process has been followed.

PRO TIP

Plan sponsors and committees may mitigate certain risks (including claims of a fiduciary breach) by avoiding common pitfalls, such as:

1. Incorporating excessively restrictive language with respect to general policies and investment monitoring.
2. Failing to follow the policies of the IPS.

BEST PRACTICE

A framework for periodic fee and service benchmarking is considered a best practice for plan governance and oversight and can be incorporated in the IPS.

1. Brian Croce, "Settlement Reached in Tussey vs. ABB Fiduciary Breach Case," *Pensions & Investments*, March 28, 2019.

MKT-8783 12/20 1777948

Dimensional

FIDUCIARY APPLICATIONS

Managing the Ongoing Operation of a Retirement Plan

Investment Manager Selection[1]

December 2020

KEY PRINCIPLES

- The fiduciary duty of care requires a prudent due diligence process to be used to select investment strategies, investment managers, and securities that serve the best interests of plan participants and beneficiaries.
- The due diligence process should be documented and consistently applied, subject to the facts and circumstances surrounding a particular decision.
- Decision making should include consideration of qualitative and quantitative criteria.

A fiduciary must be able to demonstrate that the due diligence process used to select investment strategies, investment managers, and securities meets the fiduciary "duty of care." Specifically, ERISA section 404(a)(1)(B) requires fiduciaries "to discharge [their] duties with respect to a plan solely in the interest of the participants and beneficiaries." This requirement includes the obligation to act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent [person] acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims." When it comes to the role of a fiduciary investment advisor, this "prudent person rule" is arguably elevated to a professional standard of care, becoming the "prudent expert standard."

Prudent experts are expected to apply generally accepted investment theories. The term "generally accepted investment theories" can be thought to refer to practices considered by academics and the community of professionals in the investment field to be effective in producing the desired outcomes. Given that the state of the art and science of investing evolves over time, generally accepted theories also change to reflect advances in the field. As an investment fiduciary, suitability is also implied under a duty of care.

It is important for the advisor or consultant to (1) be familiar with the universe of available investment options (i.e., mutual funds, exchange-traded products, separately managed accounts, etc.), (2) prudently select them, and (3) document the due diligence process. ERISA's prudence requirement generally comprises two components—"procedural prudence" and "substantive prudence." The former refers to the process involved in making decisions for a plan. The latter refers to the merits of the decision made by the fiduciary. The prudence requirement focuses on the fiduciary's conduct in arriving at the decision, not on its results, and asks whether a fiduciary employed appropriate methods to investigate and determine the merits of a particular decision. However, the failure to investigate may withstand scrutiny if the investment decision nonetheless was objectively prudent. So even if a fiduciary failed to conduct a sufficient investigation before making a decision (procedural prudence), the fiduciary can arguably avoid a fiduciary breach if a "hypothetical prudent fiduciary" would have made the same decision anyway (substantive prudence).

Of course, relying on substantive prudence alone runs a high risk of failure. Fiduciaries who have good intentions and a sincere belief that they are "doing the right thing" even without applying prudent procedures to substantiate thorough consideration of material facts and circumstances can be negligent, which may lead to harm. Plaintiffs in ERISA cases often quote a famous line from *Donovan v. Cunningham* (1983) that "a pure heart and an empty head are no defense."

Suggested Procedures

A sound investment due diligence process should generally have the following characteristics:

1. Applies quantitative and qualitative selection criteria that are relevant to mutual funds, collective investment trusts (CITs), exchange-traded funds (ETFs), and separately managed accounts so that the advisor or consultant can easily compare investment opportunities both across and within the different types of investment vehicles.
2. Is executed using readily accessible databases that are reliable, accurate, and verifiable.
3. Is consistent with generally accepted investment theories and practices.
4. Serves the dual purpose of prudent investment selection and ongoing monitoring.

When fiduciaries select managers or funds without following a sound due diligence process, the following problems may result:

1. Important search criteria may be omitted.
2. Performance may be compared to inappropriate indexes or peer groups.
3. Data sources may be opaque, unreliable, biased, or unverifiable.

The matrix that follows is an example of a checklist for performing due diligence. The first column lists due diligence areas that should be examined routinely. The second column provides threshold expectations suggested by Fi360 based on the organization's academic research. Each criterion not met may constitute a deficiency deserving of special consideration.

Due Diligence Criteria*	Threshold Expectations Suggested by Fi360
Regulatory oversight	Investment is managed by a: (a) bank, (b) insurance company, (c) registered investment company (mutual fund), or (d) registered investment advisor.
Minimum track record	Each investment option has at least three years of history.
Organizational stability	Portfolio management team has been in place for at least two years.
Assets in the investment	Investment has at least $75 million under management (for mutual funds, across all share classes.)
Composition consistent with asset class	At least 80% of underlying securities are consistent with broad asset class.
Style consistency	Investment is highly correlated to asset class of investment option.
Expense ratios/fees relative to peers	Investment's fees are not in bottom quartile (most expensive) of peer group.
Performance relative to peers	Compare performance relative to peer group over long time horizons.

**Note: The above criteria and thresholds are a subset of Fi360's Due Diligence Criteria and modified for use within the* Dimensional Fiduciary Resource Guide*, specifically with respect to how Dimensional considers risk, the firm's process-driven investment philosophies, and the time periods necessary to evaluate manager performance.*

It should be noted that one of the challenges of due diligence is to ensure that peer group and index comparisons to an investment option are representative of the strategy being implemented. This goal can be problematic because peer groups and indices are often selected by a third party, such as Morningstar, that may apply simplified or more generalized criteria in defining the peer groups. These criteria may include an analysis of the differences in characteristics between the peer group or index and the investment option as part of the examination of differences in relative performance.

Another important challenge of due diligence is to establish a framework or methodology to compare competing investments, taking into account the relative importance of the various criteria applied in the due diligence process.

The Fi360 Fiduciary Score® is an example of an investment rating system that weights and evaluates the eight criteria suggested in the table above. The score represents a percentile ranking of an investment relative to the other investments that make up the peer group.

Fiduciaries may, of course, apply other due diligence criteria in addition to or in place of those suggested by Fi360. The most important considerations are for the criteria and the overall due diligence process to be firmly grounded in generally accepted investment principles and applied consistently. Additionally, the decision-making process should be documented to demonstrate conformity to the prudent expert rule.

PRO TIP

When selecting target date funds (TDFs), the characteristics of the TDF (for example to or through retirement) should match the characteristics of the population of the plan. Also, to evaluate TDF performance, perform due diligence on the underlying funds and evaluate the quality of the overall lineup in each target date series as well as the goal of the overall suite. Is the TDF targeting a wealth goal or an income-oriented goal?

In addition, be sure to use the most meaningful benchmark to evaluate each type of TDF under consideration. For example, if income is the goal of a TDF, the S&P STRIDE Index Series measures the performance of a strategy that is income-oriented and designed to support an annualized stream of inflation-adjusted retirement income.

As an example of other due diligence criteria: the *Restatement of the Law Third, Trusts* (the Restatement), first published in 1992 by the American Law Institute, incorporates modern theories of investment and finance into the general language of the Prudent Investor Rule. The following excerpts offer some insight into the investment principles highlighted:

- Efficient markets and the predictive power of past performance

  "Empirical research supporting the theory of efficient markets reveals that in such markets skilled professionals have rarely been able to identify underpriced securities (that is, to outguess the market with respect to future return) with any regularity. In fact, evidence shows that there is little correlation between fund managers' earlier success and their ability to produce above-market returns in subsequent periods."[2]

- Diversification

  "As a result of the tendency of the value fluctuations of different assets to offset one another, a portfolio's risk is less than the weighted average of the risk of its individual holdings. A portfolio's expected return, on the other hand, is simply a weighted average of the expected returns of the individual assets. Thus, the expected return is not affected by the portfolio's reduced level of what is often called 'specific' or 'unique' risk—insofar as those terms are used to refer to risks that can be reduced by diversification. Other types of risk, however, are generally compensated through market pricing."[3]

- Risk-Reward relationship

  "Proper understanding and analysis of risk-reward relationships, associated strategies (such as those based on the modern portfolio theory), and the means of their implementation may be of considerable interest and importance to the trustee. This is because conscious, informed, and careful decisions and actions that are undertaken to increase portfolio risk are the prudent investor's primary path to higher expected return."[4]

An overall due diligence process implementing investment selection and ongoing monitoring criteria based on these principles can be used to demonstrate a prudent process firmly grounded in generally accepted investment practices that is not necessarily beholden to the vagaries of shorter-term performance.

To determine adherence to these principles, relevant manager selection and due diligence criteria may vary depending on the general investment approach being implemented. The table that follows shows three investment approaches broadly implemented by managers in the marketplace along with questions that may help in uncovering alignment with the principles above.

TRADITIONAL ACTIVE

- What is the body of evidence supporting the manager's ability to consistently generate higher expected returns relative to that of peers and/or benchmarks in the future?
- How credible is this body of evidence, i.e., is it supported by multiple independent, verifiably authoritative sources?
- What are the risks associated with this approach, and are they commensurate with the expected returns?
- Does the manager provide sufficient diversification?
- How transparent are the manager's approach and the sources of expected returns?

INDEXED

- How representative of the chosen asset class is the index?
- What is the body of evidence supporting the manager's ability to consistently track this index?
- How is the manager replicating the index's performance?
- How are implicit and explicit costs associated with replicating index performance managed?

FACTOR-BASED

- What is the body of evidence supporting the pursuit of a particular factor in an asset class resulting in higher expected returns relative to peers and/or benchmarks also investing in the same asset class?
- How credible is this body of evidence, i.e., is it supported by multiple independent, verifiably authoritative sources?
- What is the track record of the manager claiming to provide consistent exposure to the relevant factor and to capture the associated higher expected return?
- Are the implicit and explicit costs for pursuing these factors reasonable compared to those of other managers pursuing similar factors?
- Is the manager able to pursue these factors in a cost-effective and diversified manner?

Variable and Indexed Annuities

Variable and indexed annuities are retirement savings and income vehicles that include an investment component within the framework of an insurance contract. As such, due diligence performed on these products involves not only investment analysis, but also analysis of costs and characteristics of the insurance contract and the financial strength of the insurance company.

It's worth noting that there are a variety of charges associated with annuities beyond the costs of the investment component. Accordingly, annuities tend to be more expensive than investments that do not have insurance features. Many possible features and riders may also be associated with the insurance-based solution. The added expense of each one needs to be evaluated based on the needs and circumstances of the client.

The selection of a lifetime income provider for a retirement plan is a fiduciary act under ERISA. The Setting Every Community Up for Retirement Enhancement Act of 2019

(SECURE Act) provides a safe harbor to satisfy the prudence requirement with respect to the selection of insurers for a guaranteed retirement income contract (such as an annuity). It can protect fiduciaries from liability due to an insurer's inability to satisfy future financial obligations under the terms of the contract. The safe harbor requires the fiduciary to obtain written representations from the insurer regarding licensing, solvency, and other matters. The fiduciary must also conduct due diligence when selecting insurers, consider costs and an analysis of applicable state guarantee funds, and conduct periodic monitoring.

Final Caution

A key part of the "prudent person (or expert) rule" under ERISA requires the fiduciary to "discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and …

> *(A) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter and subchapter III."*

Take special note of this provision. The investment policy statement (IPS) is considered a governing document of a retirement plan. Due diligence procedures are often specified or outlined in the IPS, along with asset allocation guidelines. Fiduciaries must make sure that provisions specified in the IPS are aligned with actions taken in the due diligence process for selection of investment managers (and other service providers) and asset allocation practices implemented for the plan.

Plan fiduciaries must be procedurally and substantively prudent and follow instructions of governing documents.

---

1. Content for this topic was adapted from Prudent Practices for Investment Advisors, Practice 3.3, written and published by Fi360 (2019) and from other published materials from Fi360.
2. American Law Institute, *Restatement of the Law Third: Trusts;* Prudent Investor Rule (St. Paul, Minnesota: American Law Institute Publishers, 1992); Section 227- General Note on Comments e through h: Introduction to Portfolio Theory and Other Investment Concepts; Market efficiency.
3. American Law Institute, *Restatement of the Law Third, Trusts;* Prudent Investor Rule (St. Paul, Minnesota: American Law Institute Publishers, 1992); Section 227- Comment on Prudent Investing: Comment g; Risk and the requirement of diversification.
4. American Law Institute, *Restatement of the Law Third, Trusts;* Prudent Investor Rule (St. Paul, Minnesota: American Law Institute Publishers, 1992); Section 227- General Note on Comments e through h: Introduction to Portfolio Theory and Other Investment Concepts; Need for investment skill or advice.

MKT-8783 12/20 1777948

Participant-Directed Plans, Mitigating Fiduciary Liability, and Qualified Default Investment Alternatives (QDIAs)

December 2020

KEY PRINCIPLES

Plan fiduciaries remain fully responsible for—and must exercise prudence, care, skill, and loyalty in selecting and continuing to monitor—the investment elections available to participants. But careful compliance with section 404(c) regulatory requirements and the QDIA requirements of 404(c)(5) relieve fiduciaries of responsibility for the participants' selection of their account investment choices.

As more fully described above, plan fiduciaries are held to the exacting standards of the Employee Retirement Income Security Act of 1974 (ERISA). They are accountable (at the risk of personal liability) for exercising that responsibility with the appropriate level of expertise and "an eye single to the interests of the participants."[1] An ERISA fiduciary can also be liable for the acts of other fiduciaries. Under the ERISA co-fiduciary liability provisions (section 405), a fiduciary is liable for the breaches of another fiduciary if he or she:

- Knowingly participates or conceals the other's breach; or
- Enables another fiduciary to commit a breach by failing to carry out his/her own duties with the requisite care, skill, and prudence.

A popular defined contribution (DC) plan feature is to grant participants the freedom to make their own investment elections. However, participants do not always invest in accordance with sound investment theory. For example, someone in their 60s with no savings outside of the plan may choose to invest 100% of their savings in a non-diversified asset class. In addition, an increasingly large percentage of plan participants fail to make any investment decisions at all.

What happens if a participant invests imprudently or neglects to provide any investment directions? DC plan participants with the power to invest the assets in their accounts generally meet the functional definition of "fiduciary" by virtue of controlling their own accounts. Can the plan's formally appointed fiduciaries have liability for these participant fiduciary decisions under those co-fiduciary rules? Generally no, *provided* the plan's fiduciaries carry out their responsibilities properly and the plan complies with the exception to the co-fiduciary liability rules in ERISA section 404(c).

Under ERISA section 404(c)(1)(A), if a DC plan permits a participant or beneficiary to exercise control over the assets in the account, and he or she exercises such control, the participant or beneficiary is not deemed to be a fiduciary. In addition, under section 404(c), no person who is otherwise a fiduciary is liable for any loss resulting from the participant's or beneficiary's exercise of such control. The statute and regulations impose a number of conditions to gain this protection from the otherwise applicable co-fiduciary liability rules.

Developed for Dimensional Fund Advisors by Ian S. Kopelman, partner at DLA Piper.

Specifically, the plan must:

- Offer and identify a selection of at least three investment choices with materially different risk and return characteristics.
- Provide the ability to change investment allocations at least quarterly.
- Provide sufficient education and information about the plan to allow participants to make informed investment decisions.
- Include a declaration that the plan is intended to be 404(c)-compliant and that fiduciaries are relieved of liability for investment losses resulting from participant instructions.
- Explain how and when participants may give investment instructions and any limitations on instructions, such as restrictions on transfer.
- Describe plan provisions on exercise of voting, tender, and similar rights.
- Identify any designated investment managers.
- Describe any self-directed brokerage arrangements.
- At least annually, describe administrative expenses that may be charged against an individual account.
- At least quarterly, provide a statement of expenses.
- Provide extensive investment-related information, including performance data, benchmarks, fees, and expenses.
- Update the above disclosures when information changes.

Of course, plan fiduciaries remain fully responsible for—and must exercise prudence, care, skill, and loyalty in selecting and continuing to monitor—the investment elections available to participants. But careful compliance with the section 404(c) regulatory requirements relieves fiduciaries of responsibility for the participants' selection of their account investment choices.

What if a participant fails to make any investment elections, either when first enrolled in a plan or annually? Some history is warranted here:

The DOL originally took the position that section 404(c)(1)(A) protection was not available in the absence of an affirmative participant investment election. Further, studies had shown that automatic enrollment plans could significantly increase participation by eligible employees in employer-sponsored retirement plans. However, employers were reluctant to adopt automatic enrollment because of (1) concerns over state wage laws prohibiting automatic wage withholding for plan contributions and (2) fiduciary liability for investing participants' account balances without affirmative investment instructions in view of the DOL's position on section 404(c). In addition, employers that did offer

automatic enrollment were prone to default accounts with no investment election into "safe" funds, such as money market or stable value funds. That way, the participant would not see a sudden drop in value. Unfortunately, that participant may be unlikely to see adequate account growth as these funds may not appreciate in line with inflation.

Congress sought to address these issues with the passage of the Pension Protection Act of 2006. This law sought to enhance retirement savings through automatic enrollment by clarifying that ERISA preemption trumped state wage and hour laws, and adding an additional section to Internal Revenue Code section 404(c) on default investment arrangements. The added section 404(c)(5) provides that a participant will be treated as if he or she is exercising control over the assets in the account as long as specified notice requirements are met and the assets are invested in accordance with regulations prescribed by the Secretary of Labor. These regulations were to provide guidance on default investments that include "a mix of asset classes consistent with capital preservation or long-term capital appreciation, or a blend of both." Thus, the law effectively extended section 404(c) protection to automatically enrolled participants as well as any situation in which participants fail to provide investment direction.

The DOL accordingly issued qualified default investment alternative (QDIA) regulations in 2007, applicable to automatic enrollment situations as well as any other situation in which the participant has the opportunity to direct investment but fails to do so, such as after the elimination of an investment alternative or a change in service provider, or after a rollover from another plan. To attain this fiduciary protection, the default investment alternative must "qualify" as set out in the regulations. As the DOL explains, the regulation does not identify specific investment products. Rather, it describes mechanisms for investing participant contributions. The intent is to ensure that a QDIA is appropriate as a single investment capable of meeting a worker's long-term retirement savings needs. The regulations thus prescribe mechanisms for investing, and conditions that must be met, in order for a default investment alternative to "qualify."

The permitted mechanisms for investing include:

- An investment vehicle with a mix of investments that takes into account the individual's age or retirement date (such as a lifecycle or target date retirement fund).
- An investment service that allocates contributions among existing plan options to provide an asset mix that takes into account the individual's age or retirement date (such as a professionally managed account).
- An investment vehicle with a mix of investments that takes into account the characteristics of the group of employees as a whole, rather than each individual (such as a balanced fund).
- For the first 120 days of participation only, a capital preservation product.
- (The DOL also clarifies that a QDIA could be offered through variable annuity or similar contracts or other pooled investment funds.)

BEST PRACTICE

Participants defaulted into the plan's QDIA arrangement must receive an annual notice reminding them that they have the right to affirmatively direct their investments. Tracking participants who have been defaulted can be challenging. To ensure compliance, many plan sponsors will provide the required annual notice to all participants, indicating how it applies only to those who have been defaulted.

Additional conditions and requirements:

- Participants and beneficiaries must have been given the opportunity to provide investment directions but failed to do so.
- The plan must offer a "broad range of investment options" as defined under section 404(c) regulations and described above.
- The QDIA must be an investment company registered under the Investment Company Act of 1940 or managed by an investment manager meeting the requirements of ERISA 3(38) [see Glossary], a professional trustee, the plan sponsor, or a plan sponsor committee that is a named fiduciary.
- Participants must be given notice describing the default investment generally in advance of the first investment in the QDIA and 30 days in advance of each subsequent plan year.
- Participants must receive disclosures, such as investment prospectuses, that are provided to the plan for the QDIA.
- Participants must have the right to transfer out of the QDIA at least as frequently as a participant who affirmatively elected the investment (but no less frequently than once within a three-month period).
- No fees, restrictions, or expenses may be imposed on a participant who transfers out of or withdraws funds from a QDIA within the 90-day period starting with the participant's first investment in the QDIA (certain ongoing fees are permitted).
- Generally, the QDIA may not invest in employer securities.

PRO TIP

Coordinate with contracted service providers to ensure appropriate fund information, notices, and disclosures are provided to participants on a timely basis; otherwise, the insulation from liability for participant decisions can be lost.

It is important to note that this statutory and regulatory investment structure reflects no diminution in the grave fiduciary responsibility for selecting, maintaining, and monitoring appropriate investment options. But, through careful adherence, fiduciaries may insulate themselves from liability for decisions that participants are empowered to make, regardless of whether a particular participant chooses to exercise that power.

1. Donovan v. Bierwirth, 680 F.2d 263, 271 (2d Cir. 1982).

This guide was developed for Dimensional Fund Advisors LP ("Dimensional") principally by Ian S. Kopelman, a partner at DLA Piper LLP (US), and is intended solely to provide general guidance for plan sponsors and fiduciaries as well as investment and other retirement plan professionals. Information and opinions presented in this material have been obtained or derived from sources believed to be reliable; however, neither Dimensional Fund Advisors LP nor Mr. Kopelman represent that this information is accurate and complete, and it should not be relied upon as such.

Dimensional Fund Advisors LP and DLA Piper are separate, unaffiliated entities. Mr. Kopelman is an occasional speaker at events sponsored or hosted by Dimensional Fund Advisors LP.

Dimensional Fund Advisors LP is an investment advisor registered with the Securities and Exchange Commission.

The articles are distributed for informational purposes only and should not be considered investment, tax, or legal advice or an offer of any security for sale.

Dimensional does not endorse, recommend, or guarantee the services of any advisor, advisory, or consulting firm, nor any plan, person, or entity discussed herein.

Products may be mentioned or discussed that are not offered or sold by Dimensional Fund Advisors. Links to material hosted on another website are provided merely for convenience and do not imply any endorsement, representation, or warranty by Dimensional Fund Advisors with respect to any such linked website or the content, products, or services contained or accessible through such website or its operators. Linked sites are not under the control of Dimensional Fund Advisors, and Dimensional Fund Advisors is not responsible for the contents of any linked site or link contained in a linked site or any changes or updates to such site. Dimensional Fund Advisors disclaims responsibility for the privacy policies and customer information practices of any third-party website.

Investing involves risks. There is no guarantee investment strategies will be successful, and it is possible to lose money.

MKT-8783 12/20 1777948

Asset Allocation Solutions– Evaluation and Selection[1]

December 2020

KEY PRINCIPLES

- The fiduciary duty of care generally requires proper diversification of the portfolio to mitigate against the risk of large losses.
- For participant-directed plans, selected asset classes should provide participants with the ability to appropriately allocate their portfolio given their investment time horizon, risk/return profile, and overarching objectives (e.g., income in retirement, wealth accumulation, etc.).
- Pre-diversified investments, such as target date funds, should be selected to provide appropriately weighted asset class exposures for the range of time horizons and risk/return profiles of plan participants.
- The underlying funds in pre-diversified investments should meet prudent due diligence selection and monitoring criteria.

An advisor or consultant is routinely responsible for recommending or choosing an appropriate combination of asset classes (and their weightings) when creating and optimizing a client's portfolio. That process involves structuring the portfolio to achieve the client's investment objectives in the context of their risk tolerance and time horizon. Asset class selection and allocation decisions routinely tend to have greater impacts on the long-term performance of a portfolio than the selection of money managers or individual investments.

Special Considerations under ERISA

ERISA section 404(a)(1)(C) requires fiduciaries of an ERISA-covered plan to discharge their duties by diversifying the investments of the plan in an effort to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so. Thus, an ERISA fiduciary should not "normally invest all or an unduly large portion of funds in a single security, or in any one type of security, or even in various types of securities that depend on the success of one enterprise".[2] If a compelling reason does exist to invest a substantial portion of plan assets in one investment, the onus is on the fiduciary to demonstrate and document that they investigated the reasons why the investment is prudent and how the risk of large loss resulting from non-diversification will be mitigated.

In the case of participant-directed plans, participant demographics and behavioral issues also play a part in asset class selection. The plan must give participants the ability to appropriately allocate their portfolio given their individual time horizon and risk and return parameters, whether it's a younger worker with a long-term time horizon or someone nearing retirement.

That said, the behavior of participants is often a function of the options presented to them. To mitigate the risk of participants allocating assets across all available asset classes equally or concentrating their assets into a single asset class, the advisor may consider making available age-based or target risk funds or models for those who are unable or uninterested in formulating an appropriate asset allocation strategy on their own.

Qualified Default Investment Alternative (QDIA)—ERISA Safe Harbor

The Pension Protection Act of 2006 created a safe harbor for plan sponsors to avoid fiduciary liability when plan participants fail to specify how their contributions are to be invested. In such cases, plan sponsors can place participants in any of three approved pre-diversified qualified default investment alternatives (QDIAs): target date funds (TDFs); a diversified product or portfolio with a target level of risk that is appropriate for the participants overall (such as a balanced fund); or a managed account (or set of managed accounts) that may emulate either the target date or target risk characteristics of the other two types of QDIAs. The safe harbor protects the plan sponsor from liability associated with losses that may occur in the QDIA.

BEST PRACTICES

- Consider both the accumulation and decumulation investment vehicles used in selecting TDFs.
- The SECURE Act of 2019 includes a new safe harbor for plan fiduciaries who perform required due diligence on annuity products used in a 401(k) to provide retirement income.
- All investments selected to populate a plan menu should meet sound and objective due diligence criteria that are consistently applied. See Fi360's *Prudent Practices for Investment Advisors*, Practice 3.3, for discussion of prudent due diligence processes.

In order for safe harbor protection to apply, certain conditions must be fulfilled. The most fundamental condition: plan fiduciaries must carefully consider the appropriateness of the three QDIA options for serving the best interests of the participant pool as a whole and choose accordingly.

There are two fundamental due diligence obligations associated with QDIAs: the first is choosing the right type of QDIA and the second is choosing the right provider for the type of QDIA selected. Due diligence on what type of QDIA to offer hinges on understanding why a person saving for retirement should choose a particular QDIA.

For example, target date funds provide a glide path of changing asset allocations as an anticipated retirement date approaches and withdrawals are expected to begin. It is also important to note that the glide path, and the related asset allocation, can differ in a material way when considering various asset management firms. TDFs generally transition over time from equities to less volatile asset classes, such as fixed income, as participants approach their retirement date.

Conversely, target risk portfolios (commonly called conservative, moderate, or aggressive) are designed to focus on the ongoing accumulation of assets. The premise is that, for many participants, retirement will occur at an uncertain time in the future and many things can happen (a job change or other event resulting in an unanticipated liquidation of the investment, for example) that could be inconsistent with the assumptions underlying a TDF. The client profile for a target risk portfolio is more oriented to maintaining a static asset allocation to save for retirement.

Plan fiduciaries should be able to demonstrate that they have considered all QDIA types and aligned their selection to the appropriate overall participant profile. They can then proceed to perform due diligence on the products and service providers that can best deliver the chosen type of QDIA. Maximizing the potential for positive participant outcomes and minimizing regulatory and litigation risks depend on fulfilling both forms of required due diligence.

Understanding the Tools of Asset Allocation

Asset allocation models and portfolio optimization tools can assist in assessing the risk-projected return profiles of alternative asset mixes. Outputs of those tools are dependent upon the inputs—specifically, the assumed risk and projected return characteristics of each asset class under consideration and assumed correlations among those asset classes. These risk, projected return, and correlation inputs, known as capital market assumptions (CMAs), depend critically on the estimation methods and can vary over time based on changing economic and market conditions, shifting characteristics of industries and asset classes, and other unknown or unpredictable factors. Computer optimization models typically use index risk and return assumptions. That means they presume that non-systematic risk for each asset class is not material. Diversification across asset classes serves to reduce non-systematic risk in the context of a broad, multi-asset class market. It is important to recognize the noise in CMA estimates and understand how sensitive the projected investment outcomes are to changes in these estimates.

Fiduciaries should take care to evaluate asset allocation models, portfolio optimization tools, and underlying CMA assumptions to make sure that they are academically sound and objective.

It is also important to remember that there is more to making sound asset allocation recommendations than using valid CMA values. The proper context for decision making by fiduciaries always starts and ends with keeping the best interests of plan participants and beneficiaries in mind. When it comes to asset allocation decisions for retirement plans, the key factors to focus on are the range of participant retirement income objectives, investment time horizon expectations, and risk tolerance and capacity profiles that must be considered.

PRO TIP

If a plan offers a target date fund series as a QDIA, it can be a good idea to include one or more target risk fund options in the plan menu. This approach will permit plan participants to proactively select a target risk fund if it would be more appropriate for their circumstances.

1. Content adapted from *Prudent Practices for Investment Advisors*, Practice 2.4, written and published by Fi360 (2019) and from other published materials from Fi360.
2. Liss v. Smith, 991 F. Supp. 278 (SDNY 1998).

MKT-8783 12/20 1777948

Investment Monitoring and Performance Benchmarking[1]

December 2020

KEY PRINCIPLES

- Periodic monitoring reviews should compare investment performance against appropriate market and peer group benchmarks and overall portfolio objectives.
- Prudent monitoring of investments should mirror the due diligence process used to select them.
- Decisions to retain or replace investments should be documented.
- Monitoring activities must conform to governing documents, such as the investment policy statement.
- Participants in defined contribution plans should regularly receive information necessary to make sound investment decisions.

As an ongoing fiduciary obligation, monitoring is both time consuming and crucial to long-term investment success. The role of the fiduciary responsible for investment selection and monitoring is to choose and maintain prudent investments for those who have a vested interest in portfolio returns (i.e., plan participants and beneficiaries).

For a fiduciary investment advisor serving individual investors (retail or wealth management clients), the return beneficiary and the client are generally the same. Because the advice provided is personalized, the facts and circumstances influencing portfolio design and investment decision making are well defined. Moreover, direct communication between the advisor and the client/beneficiary facilitates collaboration and the mutual understanding of investment objectives and results.

Monitoring and Performance Benchmarking for Institutional Clients

For fiduciary advisors serving institutional clients, the situation is more complicated because the institutional client is not a return beneficiary. In this case, the advisor and the institution are co-fiduciaries acting on behalf of the return beneficiaries. The shared fiduciary duties of the advisor and institution must be defined and responsibly allocated. Typically, the advisor manages the monitoring process, and the institution's responsible fiduciary (e.g., an investment committee) oversees the process.

Most charitable organizations and defined benefit (DB) plans manage pooled portfolios for their return beneficiaries. The investments in these portfolios are often liability-driven in that they are intended to optimally meet specific distribution obligations or targets. For DB plans, the benefit obligations to plan participants and beneficiaries place investment risk on plan sponsors. Similarly, charitable organizations are generally subject to distribution regulations, albeit with greater flexibility and less investment risk and fiduciary liability than for defined benefit plan sponsors.

When managing the monitoring process for pooled portfolios (i.e., portfolios that are not directed by participants or beneficiaries), the advisor should establish performance expectations relative to appropriate benchmarks for the overall portfolio, each represented asset class, and the investments within the asset classes. The advisor should then use that information as part of a robust and consistent process to make informed decisions about the efficacy of the current strategy and specific investments.

Individual investments should be compared to asset class and peer group benchmarks (particularly important for actively managed funds). Relevant peer groups can include a sub-asset class or style, such as large cap value, rather than using the S&P 500 or a total market index for every equity position. The collective performance of the investments within an asset class (and sub-asset classes) should be compared to best-fit benchmarks.

However, it is important to note that even within the same sub-asset class or style, there can be substantial differences across strategies. A fiduciary should know how a strategy is designed (the underlying philosophy and research) and managed to better assess the strategy's value-add and what drove its return differences vs. other strategies.

Equally important is an understanding of the noise in returns across different benchmark indexes for the same asset class. For example, both the Russell 2000 Index and the S&P SmallCap 600 Index are US small cap stock indices, but as of August 2018, the difference in the prior 12-month return between these indices was over 7%.[2] This can occur because of differences in the subjective rules Russell and S&P apply to define their indices. It would be challenging to argue that one index is superior to the other, but they can certainly deliver very different returns over quarterly, annual, or longer performance periods.

Overall portfolio performance should be compared to a blended benchmark with appropriate indices weighted according to the asset class composition of the portfolio. If the asset allocation of the portfolio is tactically managed, blended benchmarks for the portfolio should be calculated and compared for both the target strategic allocation specified in the investment policy statement (IPS) and for the current allocation in order to determine the contribution to returns (positive or negative) earned as a result of making tactical allocations that depart from the strategic target allocation.

Rebalancing

For individual clients and institutional clients with pooled portfolios, monitoring procedures should include an examination of scheduled contributions and distributions as part of portfolio rebalancing protocols. In this way, the advisor can more cost-effectively rebalance the portfolio to strategic allocation targets, considering any applicable tax, transaction costs, and other material considerations.

The legal standard of care for rebalancing is one that a reasonably prudent person would observe under a given set of circumstances. An investment fiduciary who subscribes to such a standard, as imprecise as the term may seem, can often avoid liability for negligence by following a consistent process.

Monitoring and Performance Benchmarking for Participant-Directed Plans

Participant-directed defined contribution (DC) retirement plans are unique in many respects. Most significantly, plan participants have individual accounts and choose from among available investments; consequently, they bear the investment risk

BEST PRACTICES FOR RETIREMENT PLAN INVESTMENT COMMITTEES

- Meet regularly to review current information (typically quarterly; at least annually).
- Carefully evaluate the evidence of whether the investments are serving their intended purposes and are competitive with available alternatives.
- Act appropriately based upon the evidence and precedents established through previous deliberations and actions.
- Document the evidence gathered, the substance of deliberations held, and the decisions made. Apparent inconsistencies with other decisions should be discussed and documented to reflect the line of reasoning applied.
- For DC plans, provide participants with information and other resources that will help them to make sound decisions when selecting, monitoring, and adjusting their investment holdings.
- For institutional clients managing pooled portfolios (such as defined benefit plans), include prudent rebalancing protocols and attribution analysis as part of the monitoring process.

associated with their holdings. Investments available in the plan menu are selected by the fiduciaries to give participants the ability to choose investments appropriate to their circumstances. Because participants can only choose from among the options available in the plan menu and the quality of the investment lineup available in the plan will directly impact their retirement income, setting and maintaining the plan investment menu are critical fiduciary responsibilities.

A defined contribution plan investment menu should, at an absolute minimum, allow participants to structure a portfolio that can be diversified across the three most fundamental types of asset classes: equities, fixed income, and cash equivalents. In actual practice, plan menus often provide the ability to diversify across sub-asset classes and include a pre-diversified investment, such as a target date fund series, as a qualified default investment alternative (QDIA).

The monitoring process for DC plans includes the obligation for fiduciaries to consider whether any changes are needed in the asset classes represented in the plan menu and the type of QDIA offered; however, decision making inevitably focuses upon whether to retain or replace investments in the plan menu. Due diligence procedures, including performance benchmarking, are central to that process.

The Decision to Retain or Replace Existing Investments

When an investment fails to meet established due diligence criteria and performance expectations, fiduciaries must decide whether it is best to retain or replace that investment. The decision should not be made based solely on prior performance. What matters is having confidence that the investment will meet expectations going forward. One way to manage those decisions is by having established "watch list" procedures.

Evaluate investments in the existing plan menu by applying the same due diligence criteria used to select investments. When an investment's attractiveness compared to like-kind alternatives materially declines based upon defined criteria, it should be placed on a watch list for closer scrutiny. There are no established mandates for when an investment should be added to the watch list or removed from a portfolio or plan lineup. Therefore, it is up to the fiduciaries to put in place criteria for providing warning signs that an investment may no longer be the best available alternative. Like so many other areas of fiduciary responsibility, the most important phrase to remember is "sound process, consistently applied." However, the process should also allow for flexibility to ensure that unforeseen circumstances and considerations can be taken into account.

In the end, the decision to retain or terminate a manager or investment requires judgment, backed by quantitative and qualitative evidence. It is the fiduciary's confidence in the investment or manager's ability to perform in the future that should ultimately drive selection and retention.

PRO TIP

Advisors can provide clients a valuable service by conducting attribution analysis.

**Not applicable for participant-directed plans.*

Frequency of Reviews

In keeping with the duty of care, fiduciaries must determine a reasonable schedule for reviews as part of the monitoring process. They should consider the following factors: (1) requirements established in governing documents or by law or regulations, (2) decision maker preferences, (3) prevailing economic and market conditions, (4) the complexity or risks associated with investments and strategies employed, and (5) material changes in the profile or circumstances of return beneficiaries.

Fiduciaries should generally monitor investments at least quarterly, and more frequently as required by facts and circumstances in the absence of any pressing issues. Performance reports should generally be prepared at least quarterly, and advisors, if any, should review these reports as they are prepared. Performance reports should be provided to the decision makers and discussed as necessary to keep the portfolio current with the client's objectives.

Retirement plan participants and beneficiaries must be provided information as required by laws, regulations, and governing documents.

Summary

Monitoring is an active and ongoing obligation. It involves (1) keeping current on changes in laws, regulations, and governing documents; (2) reexamining previous asset allocation and investment selection decisions in light of new facts and circumstances; and (3) evaluating the merits of making changes to the portfolio to serve the best interests of return beneficiaries.

In a unanimous decision in the case of *Tibble v. Edison International*, the Supreme Court held that a plan fiduciary has a continuing duty to monitor the prudence of investment options. In this case, the Court found that the continuing duty to monitor means that imprudent retention of an investment, not just the imprudent selection, can constitute a fiduciary breach. Thus, as a result of the duty to monitor, the clock on accountability in a fiduciary relationship never stops.

---

1. Content was adapted from *Prudent Practices for Investment Advisors*, Practice 4.1, written and published by Fi360 (2019), and from other Fi360 published materials.
2. Past performance is no guarantee of future results.

MKT-8783 12/20 1777948

Benchmarking and Evaluating Plan Fees

December 2020

KEY PRINCIPLE

ERISA requires plan fiduciaries to act skillfully, prudently, and solely in the interest of plan participants when choosing a service provider and to pay only "reasonable" expenses for plan investment and administrative services.

Choosing a service provider is a fiduciary act. Consequently, ERISA requires that the persons making that choice exercise skill and prudence and act solely in the interest of plan participants when initially choosing a service provider and when monitoring that provider over time. Assessing the reasonableness of fees charged to the plan is an important part of exercising that fiduciary responsibility. Under ERISA, a plan may pay only "reasonable" expenses for services the plan needs, such as investment and administrative services [section 404(a)(1)]. Most plan sponsors and fiduciaries are aware of the recent increase in litigation against plan fiduciaries that alleges excessive plan expenses. Unfortunately, to avoid unreasonable fees and expenses, the typical plan provider faces significant challenges in trying to determine what is "reasonable."

Fee arrangements can be especially complex. Investment solutions are often opaque, with fee structures that vary across share classes. In addition, a wide variety of administrative service models, including those that are bundled and unbundled, have differing fee structures. Indirect compensation, which includes revenue sharing, is another consideration that adds complexity in assessing the reasonableness of the service provider's fees. Revenue sharing includes, for example, payments from investment providers to other service providers (typically a recordkeeper) in exchange for the performance of certain functions that the investment provider would otherwise have to perform (e.g., distribution of plan prospectus materials).

Regardless of the complexity, the fees must be understood. As discussed previously in this guide, it is important to have a thorough, prudent, and documented fiduciary oversight structure. When expenses are borne by plan participants as well as the plan itself, and not paid directly by the plan sponsor, service provider fees must be carefully considered. A fiduciary without the time or expertise to do so is well advised to seek expert assistance in obtaining and reviewing all information needed and applying methodologies for assessing the reasonableness of fees.

Information required by regulations can provide a good starting point. The US Department of Labor (DOL) requires certain service providers to disclose fees (both direct and indirect) described in the regulations under ERISA section 408(b)(2), which helps plan fiduciaries assess services and related fees. The DOL also requires, under ERISA section 404, that certain providers distribute detailed fee information to plan participants in self-directed

Developed for Dimensional Fund Advisors by Ian S. Kopelman, partner at DLA Piper.

plans. These disclosures have improved fee transparency. However, there is no required standard format, which may leave participants and plan fiduciaries to sift through long, complex charts. This may leave the fiduciary vulnerable to the allegation that the disclosure was not written in a manner calculated to be understood by the average plan participant.

Fiduciary education efforts can also provide excellent guidance. The DOL (among others) offers some general guidance on reviewing fees through a variety of publications and tools, including "Getting It Right—Know Your Fiduciary Responsibility."[1] The DOL advises against looking at fees in a vacuum. Fees should be based on the qualifications of the service provider, scope of services offered, and reasonableness of the fees given the services provided. To be clear, ERISA does not require plan sponsors to select a provider with the lowest possible fees. For example, a fiduciary may determine that plan participants are better served by working with an advisor or recordkeeper that offers one-on-one participant meetings even if that kind of service costs more than another provider's level of service. The scope and quality of the services matter.

Common practices for evaluating whether fees are reasonable include (1) general plan benchmarking or (2) a more comprehensive process that involves a competitive bid from alternative service providers.

BEST PRACTICE

A fiduciary without the adequate expertise is well advised to retain an expert advisor to assist in assessing the reasonableness of fees. An advisor can decipher fee disclosures, obtain additional information if needed, and benchmark the plan to assess costs, fees, and plan design features.

The general benchmarking approach will generally use industry data to approximate the associated fees for a particular service (e.g., investment management, recordkeeping, third-party administration, and advisor fees). Benchmarking will typically begin with a review of the service provider's qualifications, service model, performance, and fees. A fee analysis is then prepared based on prevailing market prices for the services provided. This exercise can help gauge prevailing market rates. If fees are not reasonable given the services provided, renegotiating with or changing the service provider may be called for. Plan fiduciaries should retain copies of the benchmarking report in the plan's permanent files to demonstrate compliance with their responsibility to monitor plan fees.

Benchmarking, though, does not normally incorporate unique requirements for a specific plan. Competitive bidding, on the other hand, can gauge market rates calibrated to a plan's specific characteristics, providing specific pricing and service arrangements from alternative service providers. Often conducted through a request for proposal (RFP) process, this can be a substantial undertaking requiring thoughtful preparation. For a defined contribution plan, fees and other expenses can erode returns and directly affect the amount of retirement savings available to participants. For a defined benefit plan, these costs are generally borne by the plan sponsor. A plan's fiduciaries must be familiar with those fees and expenses, understand them thoroughly, and make sure they are no more than reasonable.

Dimensional Fund Advisors is pleased to offer templates for use in your retirement plan practice. This benchmarking resource is available for plan sponsors and advisors as a practice management tool, and you are welcome to customize and brand the content based on your specific needs. By proactively benchmarking current plans for clients, advisors can position themselves in a consultative role and strengthen their retentive selling efforts. The benchmarking content can also be incorporated into your ongoing sales and prospecting processes. Please contact your Dimensional representative to learn more about these benchmarking templates.

PRO TIP

The DOL requires certain service providers to disclose fees (both direct and indirect) under ERISA section 408(b), which helps plan sponsors assess services and the related fees. It also requires that providers distribute detailed fee information to plan participants in participant-directed investment plans under ERISA section 404.

1. "Fiduciary Education Campaign," US Department of Labor. *dol.gov/agencies/ebsa/employers-and-advisers/plan-administration-and-compliance/fiduciary-responsibilities/fiduciary-education-campaign*.

This guide was developed for Dimensional Fund Advisors LP ("Dimensional") principally by Ian S. Kopelman, a partner at DLA Piper LLP (US), and is intended solely to provide general guidance for plan sponsors and fiduciaries as well as investment and other retirement plan professionals. Information and opinions presented in this material have been obtained or derived from sources believed to be reliable; however, neither Dimensional Fund Advisors LP nor Mr. Kopelman represent that this information is accurate and complete, and it should not be relied upon as such.

Dimensional Fund Advisors LP and DLA Piper are separate, unaffiliated entities. Mr. Kopelman is an occasional speaker at events sponsored or hosted by Dimensional Fund Advisors LP.

Dimensional Fund Advisors LP is an investment advisor registered with the Securities and Exchange Commission.

The articles are distributed for informational purposes only and should not be considered investment, tax, or legal advice or an offer of any security for sale.

Dimensional does not endorse, recommend, or guarantee the services of any advisor, advisory, or consulting firm, nor any plan, person, or entity discussed herein.

Products may be mentioned or discussed that are not offered or sold by Dimensional Fund Advisors. Links to material hosted on another website are provided merely for convenience and do not imply any endorsement, representation, or warranty by Dimensional Fund Advisors with respect to any such linked website or the content, products, or services contained or accessible through such website or its operators. Linked sites are not under the control of Dimensional Fund Advisors, and Dimensional Fund Advisors is not responsible for the contents of any linked site or link contained in a linked site or any changes or updates to such site. Dimensional Fund Advisors disclaims responsibility for the privacy policies and customer information practices of any third-party website.

Investing involves risks. There is no guarantee investment strategies will be successful, and it is possible to lose money.

MKT-8783 12/20 1777948

Dimensional

ADDITIONAL FIDUCIARY CONSIDERATIONS

Topics a Retirement Plan May Want to Consider

Tips for Fiduciary Compliance

December 2020

KEY PRINCIPLES

Since ERISA was adopted over 40 years ago, regulations and court cases have not issued many specific guidelines for fiduciaries. Although fiduciary regulations and court decisions are often complicated, applying certain principles should help enable plan fiduciaries to achieve substantive compliance in most cases.

Part 4 of Title I of ERISA contains standards for fiduciaries' performance of their fiduciary duties. With the exception of specific rules relating to prohibited transactions, these standards are rather general and were in fact taken from the common law of trusts that has existed for hundreds of years.

The application of the standards to specific situations has generated confusion as well as trepidation among plan sponsors and in-house personnel for whom the role of plan fiduciary is only one of the many responsibilities they perform for their employers. However, with a few exceptions, the standards are logical applications of the concept that fiduciaries should act with fairness, a basic level of expertise, in a manner calculated to provide retirement benefits to participants and beneficiaries, and without being subject to conflicting concerns.

Although fiduciary regulations and court decisions are often complicated, applying certain principles will help enable plan fiduciaries to achieve substantive compliance in most cases.

To aid fiduciaries in their day-to-day ERISA fiduciary activities, we have developed a list of 14 tips:

1. ESTABLISH A PROCESS AND FOLLOW IT

ERISA doesn't require a fiduciary to always be right; rather, ERISA requires him or her to be prudent, and for the purposes of ERISA, prudence is a process. Further, if the fiduciary doesn't follow a process, the process won't demonstrate prudence or anything else (except non-compliance). So set up a reasonable process for decision making, and make sure it is followed.

2. PUT IT IN WRITING

Rules governing the plan's operations should be in writing, but they shouldn't be too complicated. Following reasonable rules goes a long way toward demonstrating fiduciary compliance, but overly complicated rules tend not to be followed, and non-compliance with plan rules and processes is a per se fiduciary breach. Equally important is a process to document in writing operational compliance and adherence to the terms of the plan.

Developed for Dimensional Fund Advisors by Ian S. Kopelman, partner at DLA Piper.

3. ALLOCATE SPECIFIC RESPONSIBILITIES

Each fiduciary should know he or she is an ERISA fiduciary, understand what that means, and be familiar with the rules governing the plan's operations, including the allocation of responsibilities among various fiduciaries. For example, when there are distinct committees, members of an investment committee are typically not responsible for administration, and members of an administrative committee are typically not responsible for investments. Making this clear may require education sessions for new fiduciaries and periodic reviews for the company's management and/or board of directors.

4. KNOW WHAT'S IN THE PLAN DOCUMENTS

Each plan must be established in writing. These documents, along with rules and guidelines for operation of the plan, govern the fiduciary's actions, and a failure to comply violates ERISA. Each fiduciary needs to keep copies of the plan documents and be familiar with their provisions. Since plan documents are updated periodically to reflect changes in the law and the plan's operation, a fiduciary also has to make sure he or she is aware of any changes.

BEST PRACTICE

ERISA doesn't require a fiduciary to always be right; ERISA requires him or her to be prudent, and for the purposes of ERISA, prudence is largely a process. So set up a reasonable process for decision making, and make sure it is followed.

5. DRAFT MORE SETTLOR FUNCTIONS

Settlor functions, such as deciding to establish or terminate a plan or changing benefit formulas or distribution options, are not subject to ERISA's fiduciary rules. Establish clear distinctions between actions that are settlor functions and fiduciary actions that are subject to ERISA, even if the same individual or committee is responsible for both. It is often possible to draft the plan so that the settlor functions are expanded, which limits the application of the ERISA fiduciary rules.

6. MEET REGULARLY AND KEEP MINUTES OF THE MEETINGS

Responsible fiduciaries should meet periodically to review the plan's operations and investment performance. Their decisions and rationale for actions and non-actions should be memorialized in written minutes, but the minutes need not be too detailed. Investment consultant or financial advisor reports and investment performance analysis documents supporting the fiduciaries' decisions should be included with the minutes.

7. GET SEPARATE WRITTEN SERVICE AGREEMENTS FROM EACH VENDOR

Service agreements should govern every relationship with an outside vendor, spelling out each party's obligations and requiring the vendor to indemnify each fiduciary and the company for liability or losses to the plan or participants resulting from the vendor's misconduct, negligence, breach of the agreement's terms, and ERISA. From the plan's and employer's perspective, a vendor's liability should, if possible, not be subject to dollar limits, and to the extent possible, the agreement should also limit the vendor's access to participants for purposes of cross-selling its services outside the plan.

8. MAKE CLEAR WHO IS A FIDUCIARY

Corporate officers or other employees frequently have fiduciary responsibility for a plan's operation. This responsibility can lead to real or perceived conflicts of interest where they also act as plan fiduciaries. A key to avoiding any fiduciary breach is to

make sure it is clear to the fiduciaries and third parties when they are—and are not—operating in their fiduciary capacities.

9. AVOID DECISION-MAKING CONFLICTS

If a fiduciary has a real or perceived conflict, he or she should not make the decision. Each fiduciary should understand his or her rights and obligations to withdraw from any decision in which there is a conflict. If the plan sponsor has a real or perceived conflict, the record must demonstrate that the conflict did not impact the decision.

10. KNOW WHAT FEES THE PLAN IS PAYING

A fiduciary can't conclude that a plan is getting what it is paying for when he or she doesn't know what the plan is paying and what the service provider is receiving. Fee disclosure rules developed by the US Department of Labor in 2012 should provide the fiduciary access to necessary information, but it is up to the fiduciary to understand the information provided and to determine if the aggregate fees and expenses are reasonable based on the value of the services received.

11. GET OUTSIDE HELP ON FEES

If the plan is being charged fees for administrative, investment, or other services, consider hiring an independent third party to make the initial recommendation as to whether billing the plan, as opposed to the plan sponsor, is appropriate or advisable. (For more information, see "*Benchmarking and Evaluating Plan Fees*" in the previous section.)

12. KNOW THE SHARE CLASSES

Mutual funds typically offer multiple share classes. Institutional share classes and "R" or retirement share classes are often available to investors with minimum investment thresholds or designed specifically for defined contribution plan participants. Often, a plan will be invested in a retail share class even though it is eligible to pay lower fees for an institutional class. Many recent lawsuits against plan sponsors and fiduciaries involve claims that participants were charged excess fees because the fiduciary failed to offer an available institutional share class (or other type of comparable but lower-cost investment vehicle). The plan should select the share class with the lowest costs available to it unless there is a demonstrable (and defensible) reason to purchase a share class with higher costs.

13. REVIEW SERVICE PROVIDER SELECTIONS AND RFPS

The initial selection of a plan recordkeeper, trustee/custodian, and investment consultant or advisor is a fiduciary decision. However, fiduciary responsibility does not end there. Fiduciaries must also monitor the performance of the plan's service providers to determine if their selection remains prudent. Even if a service provider's performance is generally adequate, the fiduciary should periodically invite several service providers to submit proposals to determine if a different provider would be a less expensive and/or a better choice.

PRO TIP

Responsible fiduciaries should meet periodically to review the plan's operations and investment performance. Their decisions and the reasons for them should be memorialized in written minutes, but the minutes should not be too detailed.

14. REVIEW PARTICIPANT COMMUNICATIONS

Typically, recordkeeping services include drafting and distributing necessary or desirable (at least in the view of the recordkeeper) disclosures and other communications to participants. These communications often feature the plan sponsor's logo or letterhead, and participants may view them as coming from, or at least endorsed by, the plan sponsor. The only way to control potential liability for any errors or misrepresentations in these communications is to carefully review and approve the language before distribution. Further, it should be made clear that the recordkeeper or other third-party administrator (TPA) is the source of any ancillary communications, such as investment education. Finally, we recommend disclosing the recordkeeper's other services, and that the plan sponsor does not evaluate or endorse them. Agreements providing for indemnification of the employer and in-house plan fiduciaries by the service provider against liability resulting from such communications should also be considered.

MKT-8783 12/20 1777948

Understanding Managed Accounts

August 2022

Introduction

As interest in managed accounts increases, we have prepared this module to provide advisors and plan sponsors with a better understanding of these arrangements from a fiduciary perspective. We will address:

- Contribution advice methodology
- Investment considerations
- QDIA structures
- Service models, data security, and fees
- Provider selection and oversight

Managed accounts and their data-driven approach can potentially strengthen participant outcomes by providing more personalized asset allocation, optimized savings rates, and additional advice for retirement planning, including decumulation strategies and Social Security election analysis. However, since plan sponsors, as fiduciaries, are required to act in the best interest of their participants and plan beneficiaries, their responsibilities extend to the addition of plan features such as managed accounts, which necessitates a comprehensive understanding of the provider's service model, investment methodology, and fees. A clear understanding of plan goals, the expected benefit of a managed account solution, and the reasonableness of fees are all essential to document due diligence both prior to the initial engagement and through periodic due diligence.

Background/Utilization

Managed accounts are certainly not new to the retirement landscape. In fact, they have been in the marketplace for many years and were specifically identified by the Pension Protection Act in 2006 as one of the three qualified default investment alternatives (QDIAs): 1) age-based products (target date funds), 2) risk-based products (e.g., balanced funds or model portfolios), and 3) managed accounts. It is important to note that the US Department of Labor (DOL) refers to the first two QDIA options as products, but to a managed account arrangement as a service. Target date funds (TDFs) are currently the most popular QDIA, but managed account adoption has been growing in recent years according to the Callan Institute's 2022 Defined Contribution Trends Survey.[1]

Developed for Dimensional Fund Advisors by Ian S. Kopelman, partner at DLA Piper.

Understanding Managed Accounts

It is important to clearly define how managed accounts differ from a target date fund or an investment advice solution. TDFs provide a single asset allocation for a specific cohort of participants and treats them all as having the same goal, objectives, and risk tolerance, based on their proximity to retirement. An advice recommendation is a point-in-time service that is typically limited in scope and does not include an ongoing obligation or service, oftentimes at no cost. Managed accounts can leverage data and technology to deliver customized portfolio management informed by personal factors provided by the plan's recordkeeper as well as any additional information provided directly by the participant. The managed account provider also generally serves as a 3(38) fiduciary. Using each participant's demographic information gathered through recordkeeping data (e.g., account balance, age, compensation, etc.) and/or provided by the participant (e.g., outside asset information, desired retirement date, etc.), the managed account provider implements a personalized asset allocation. For example, in addition to incorporating more data points than target date funds initially, managed account services may also be able to incorporate information about ongoing participant life events, such as plan loans, marriage, etc. Participants who engage may provide additional data for an even more tailored experience and may be able to take advantage of other services usually available only to wealth management clients. Some of these services include:

- Optimal savings rate recommendations
- Retirement readiness analysis
- Social Security election recommendations
- Retirement distribution and withdrawal analysis
- Budgeting and other financial tools

Contribution Advice Methodology

As discussed in the "Fiduciary Roles and Responsibilities" module, ERISA defines fiduciary status based on the scope of responsibility, providing that a Section 3(21) fiduciary generally renders investment advice, whereas a Section 3(38) fiduciary has the power to manage the assets, must be a registered investment advisor or a bank or insurance company of requisite size, and acknowledge its fiduciary status. A managed account provider (assuming it's a registered investment advisor, bank, or insurance company) will generally be responsible, as a 3(38) investment manager, for making decisions about the asset allocation of a participant's account. In addition to the role of an investment manager, a managed account provider may also offer advice regarding optimal savings rates, retirement readiness, etc. The contribution advice methodology may vary among different providers. For example, some may recommend that participants increase their savings rates on an incremental basis (e.g., an increase of 1% to 3% per year). This approach, to nudge participants to better outcomes, aligns with *Save More Tomorrow*—a behavioral solution pioneered by Shlomo Benartzi.[2] Other managed account providers recommend that the participant immediately begin

saving the amount necessary to achieve retirement readiness, regardless of how much that would mean in increased savings. In addition, some providers will recommend the participant contribute less if they are on track, while other providers do not advise a participant to reduce their savings rate.

We are not stating that any one single approach is better than another; however, it is important to note that the differences in contribution advice methodology may produce different outcomes, and plan sponsors should understand how to monitor the program's effectiveness.

Investment Methodology Considerations

From a portfolio implementation standpoint, it is important for the plan sponsor to understand the investment methodology used by the managed account provider. Plan sponsors should understand how participant demographics and inputs impact portfolio recommendations and management. Required data points differ among managed account providers. Many include age, account balance, compensation, gender, etc., and allow the participant to input additional data points, such as outside assets, spousal retirement information, and the like. For example, certain providers require a date of retirement to develop the portfolio, whereas others consider it an optional input for further customization. These differences may lead to different participant outcomes.

It is also helpful to understand which data element has the greatest impact on asset allocation. Oftentimes, the participant's retirement age, current age, and account balance will have the greatest influence over asset allocation, but again the investment methodology will vary among different providers.

Plan sponsors should also understand the requirements for portfolio construction. Potential questions include:

- Are there required asset classes?
- Is the allocation based on the plan's core investment fund lineup, or does it allow for funds not included in the core lineup to be used specifically just for the managed account arrangement (i.e., non-core funds)?
- Does the managed account provider liquidate current holdings immediately and move the account into the recommended portfolio, or rely on a gradual process over a transition period to achieve the targeted allocation?
- How were the investment fund options that underlie the allocations determined by the managed account service selected?

Some refer to variations in asset allocations produced by the algorithm as a managed account glide path, similar to a TDF glide path. The differences with a managed account are that the inputs go beyond just age and the glide path is customized to a greater extent.

One approach for due diligence and analysis might be to use only minimal/required inputs from the recordkeeping system (i.e., no additional inputs from the participant) and analyze the managed account allocations for various age cohorts to determine if you are comfortable with the respective glide paths/asset allocation. Are they reasonable based on generally accepted investment and portfolio management principles?

QDIA Structures: Opt-In or Opt-Out

Plans can also offer a managed account service as a QDIA, and plan sponsors then default new participants into their service once they satisfy the eligibility conditions of the plan. QDIA considerations are discussed at length in the "Participant-Directed Plans, Mitigating Fiduciary Liability, and Qualified Default Investment Alternatives (QDIAs)" module. Sponsors may also re-enroll all participants into the managed account, with proper notice and while providing the ability to opt out of the re-enrollment. Alternatively, sponsors may offer the managed account service on an elective basis (i.e., not as a QDIA arrangement). As for the possibility of plan sponsors selecting managed accounts as their QDIA, a recent Cerulli survey finds that nearly half of target date managers expect managed account usage as a QDIA to increase during the next one to three years.[3]

We have also observed wider market developments in the area of "dynamic" or "hybrid" QDIAs for a given plan, which incorporates more than one plan default. For example, younger participants may be defaulted into the plan's TDF while older participants are defaulted into a managed account solution. Dynamic QDIAs are a fairly recent innovation. The plan's recordkeeper needs to be able to manage the operational process as participants transition from the TDF to the managed account solution.

When evaluating a managed account arrangement as a potential plan enhancement, it is essential to understand the goals of the plan sponsor, the structure of the plan, participant tenures, industry type, etc. For example, do the company's participants have short or long tenures? It may also be helpful to evaluate whether plan participants could benefit from a dynamic QDIA approach as their circumstances become more complex later in life.

Service Models, Data Security, and Fees

The two primary managed account service models are direct and subadvised.

Direct: With this model, the recordkeeper hosts the managed account solution but does not assume the role of a fiduciary or money manager (the managed account provider is the Section 3(38) fiduciary and receives the associated advisory fee). An investment advisory firm provides the managed account service to the plan sponsor for a fee, based on the technology integration and data provided by the unrelated recordkeeper.

Subadvised: In this model, a managed account provider receives a fee for providing investment management services that support the recordkeeper's advisory firm solution. The recordkeeper's RIA firm serves as the Section 3(38) advisor and may receive managed

account advisory fees from plan sponsors. If the recordkeeper receives additional revenue in conjunction with the managed account solution, the additional compensation should be considered a part of the overall fees for service by the recordkeeper.

Plan sponsors should also consider the call center support structure (e.g., is it provided by the managed account provider or the recordkeeper?). The online participant experience is also important as we consider existing calculators and tools hosted on the recordkeeping platform. It may be helpful to review any web-based tools for consistency of guidance with the managed account recommendations/advice.

Provider Selection and Oversight

The process for evaluating, selecting, and monitoring managed account providers is similar to any other investment-related decision in some ways, but more challenging in other ways. We start with the determination of whether the managed account service provides incremental value to plan participants and whether the additional fee is reasonable, given the scope and quality of the service provided.

Plan sponsors should thoroughly evaluate the managed account arrangement at the time of adoption and on an ongoing basis to ensure that the service is effective, continues to add value, remains suitable for plan participants, and has reasonable fees. Analyzing retirement readiness metrics over time may be particularly helpful. Managed account providers offer a variety of analytics and management reports to support ongoing due diligence efforts, including the following:

- Plan level and individual/cohort retirement readiness metrics
- Savings rate trend analysis
- Comparative analysis between managed and non-managed accounts
- Analysis related to the drivers of investment performance (attribution analysis)
- Participant engagement levels (i.e., those who have provided additional data to optimize their portfolio)

One of the key considerations for oversight is related to the fact that managed accounts are not discrete investment products; they are a service. Many of the success factors referenced above can inform or help gauge the effectiveness and value of the offering. This should supplement ongoing due diligence on the continued appropriateness of the underlying investment funds used within the managed account service. Each fund in the portfolio will have its own design, strategy, and stated objective, as well as prospectus benchmark. It should be noted that performing performance analysis based on the weighted average returns of portfolio mixes may not be possible nor relevant, as each participant's allocation would likely be customized to their unique circumstances. Rather, metrics tied more closely to participants' progress toward their retirement goals may be more appropriate. We recognize each managed account provider will have its own tools and solution set based on its technology platform and system capabilities.

Additional Fiduciary Considerations

As discussed earlier, the appointing fiduciary has the obligation to prudently select and monitor the manager as they carry out their responsibilities and functions. Oftentimes, the investment manager will obtain information regarding non-plan assets in order to manage the participant's portfolio. This can be problematic if the information is used by the manager for unauthorized purposes and/or personal gain. The investment management agreement between the plan sponsor and investment manager should include language prohibiting the misuse of data obtained in connection with the relationship. In addition, to limit or reduce misunderstandings and co-fiduciary liability, participants should be made aware, in writing, that neither the plan sponsor nor plan fiduciaries are endorsing the manager. Participant communications should also make clear that it is each participant's responsibility to determine whether the manager's offering is appropriate for his or her individual circumstances.

The Role of an Advisor

One of the more recent innovations in the managed account space allows plan advisors to incorporate their investment philosophy, asset allocation, and fund selection capabilities within the managed account arrangement. By opening up the managed account structure to incorporate advisors' investment preferences and framework, which plan sponsors are accustomed to, they can now deliver personalized retirement planning advice to participants in a scalable and efficient manner. Plan sponsors have a better understanding of investment allocation constructs, and participants can more fully engage with their familiar, trusted advisor. The advisor managed account structure may be more aligned with plan sponsor investment expectations based on their investment philosophy and view of capital markets. With the stepped-up engagement by participants facilitated by plan advisors, we expect to see far greater adoption and participant customization through additional data inputs as interest in advisor managed accounts continues to grow. In fact, while the algorithmic, scalable nature of digital advice may generally come with lower overhead costs, Cerulli Associates suggests that financial advisors are often better suited to address the behavioral aspects of saving and investing, which may be particularly important during periods of market volatility.[4] Pairing institutional-quality, customized solutions with the plan's trusted advisor may offer all participants the best opportunity for successful retirement outcomes.

Summary

Plan sponsors should take great care to define an appropriate process for selecting and monitoring the managed account service provider. Due diligence procedures are often specified or outlined in the Investment Policy Statement. Those procedures should be updated, if needed, to fit the specifics of the managed account structure. We are also supplementing this module with a sample IPS document that contains managed account considerations.

1. "2020 Defined Contribution Trends Survey," Callan Institute white paper, 2022.
2. Shlomo Benartzi, *Save More Tomorrow: Practical Behavioral Finance Solutions to Improve 401(k) Plans* (New York: Portfolio, Penguin Random House, 2012).
3. "Cerulli Edge—U.S. Retirement Edition, 1Q 2021 Issue," Cerulli, March 2022.
4. "Cerulli Edge—U.S. Retirement Edition, 1Q 2021 Issue," Cerulli, March 2022.

MKT-8783 08/22 2272209

Navigating ESG in Retirement Plans

April 2022

KEY PRINCIPLES

Core fiduciary guidance from the US Department of Labor (DOL), as again modified by the recently proposed regulations (October 14, 2021), is as follows:

- Consideration of the projected return of the portfolio relative to the funding objectives of the plan may often require an evaluation of the economic effects of climate change and other ESG factors on the particular investment or investment course of action.
- If a fiduciary prudently concludes that climate change or other ESG factor is material to an investment under consideration, the fiduciary should consider it and act accordingly.
- Proxies should be voted as part of the process of managing a plan's investment, unless a plan fiduciary determines that voting proxies may not be in the plan's best interest because, for example, voting would involve significant expense or effort.

Given continued and growing interest in environmental, social, and governance (ESG) considerations in connection with investing plan assets by plan participants and fiduciaries, the latest proposed rule from the US Department of Labor (DOL) is a welcome relief. ESG regulations DOL issued under the Trump administration (removing prior sub-regulatory guidance and amending the Investment Duties regulation [the "2020 Rule"]) were widely perceived to create obstacles to the incorporation of ESG considerations, even singling out ESG investing for heightened scrutiny and prohibiting the use of ESG investments as qualified default investment alternatives. The Biden DOL has worked to counter this perception with its newly issued proposed regulation, which affirms that fiduciary responsibility may not only permit, but often in fact *require*, evaluation of the economic effects of climate change and other ESG factors on a particular investment or investment course of action. The DOL expresses concern that the 2020 Rule, if left unchanged, could expose plans' investments and portfolios to avoidable climate change-related risks that negatively impact performance, and has solicited comments on whether climate change risk should be considered presumptively material in assessing investment risk and return. The DOL is thus once again clarifying application of ERISA's fiduciary duties of prudence and loyalty in selecting investments and exercising shareholder rights, such as proxy voting.

There's a history to this. Retirement plans governed by ERISA have remained to a certain extent on the sidelines of ESG investing due largely to inconsistent guidelines from the DOL. While the DOL has consistently articulated the core principle that an ERISA fiduciary, who must act prudently and solely in the interest of participants and beneficiaries, may not sacrifice return to further social goals, differences in tone and emphasis seeming to favor or to discourage ESG investing have alternated for decades as Republican and Democratic administrations changed places. ESG's apparent discouragement may have reached its zenith with the Trump administration regulation with its skeptical tone, additional documentation requirements, and outright prohibition on the use of ESG investments as qualified default investment alternatives.

If finalized largely as proposed, this new rule should significantly ease these concerns. In the proposed regulation, the principle remains that fiduciary decision-making must be grounded in prudent analysis of economic factors, and the DOL reaffirms as the bedrock principle of ERISA's duty of loyalty and prudence that a fiduciary may not

Developed for Dimensional Fund Advisors by Ian S. Kopelman, partner at DLA Piper.

subordinate the interests of the participants and beneficiaries in their retirement income or financial benefits under the plan to other objectives and may not sacrifice investment return or take additional investment risks to promote goals unrelated to the provision of benefits. However, as the DOL's new proposed rule makes clear, climate change and other not so traditional social and governance factors *can be* economic factors that *are not* unrelated to the provision of benefits. Thus, ERISA plans should not be left behind as other investors around the globe increasingly incorporate ESG factors among all other relevant factors in investment decisions.

Newly Proposed Rule from the DOL on ESG Options

The DOL set out to counteract the feared negative perception caused by the Trump administration's 2020 Rule on the use of climate change and other ESG factors in investment decisions through a new proposed regulation (the "2021 Proposed Rule") published on October 14, 2021. The stated benefit of the 2021 Proposed Rule is to ensure that plans do not overcautiously and improvidently (in light of that 2020 Rule) avoid considering financially material climate change and other ESG factors when selecting investments or exercising shareholder rights.

The 2021 Proposed Rule amends the 2020 Rule in the following significant ways.

1. Adds language on investment prudence duties to specify that consideration of projected return may often *require* an evaluation of the economic effects of climate change and other ESG factors.

2. Clarifies that a fiduciary may consider any factor material to the risk-return analysis, including climate change and other ESG factors that are no different from other "traditional" material risk-return factors. If a fiduciary prudently concludes that climate change or other ESG factor is material to an investment under consideration, as with any material risk-return factor, the fiduciary should consider it and act accordingly. To eliminate unwarranted concerns about investing in climate change or ESG funds that are economically advantageous, the 2021 Proposed Rule provides the following non-exhaustive examples of factors that, depending on the facts and circumstances, may be material to a fiduciary's prudent risk-return analysis:

   - Climate change-related factors, such as a corporation's exposure to the real and potential economic effect of climate change, including exposure to the physical and transitional risks of climate change and the positive or negative effect of government regulations and policies to mitigate climate change.
   - Governance factors, such as those involving board composition, executive compensation, and transparency and accountability in corporate decision-making, as well as a corporation's avoidance of criminal liability and compliance with labor, employment, environmental, tax, and other applicable laws and regulations.
   - Workplace practices, including the corporation's progress on workforce diversity, inclusion, and other drivers of employee hiring, promotion, and retention: its investment in training to develop its workforce skill.

3. Removes the prohibition on selecting an ESG-themed fund as a plan's qualified default investment alternative (QDIA).

4. Removes from the "tiebreaker" concept the requirement that a fiduciary can only use a collateral benefit as a tiebreaker in choosing between economically indistinguishable investment alternatives as well as the heightened documentation the 2020 Rule had required. The DOL adopts a broader formulation applying the tiebreaker concept when choosing among investments that need not be economically indistinguishable but may differ on a wide range of attributes while serving the financial interests of the plan equally well. The DOL clarifies that the tiebreaker concept comes into play when an ESG factor is not in fact material to the risk/return analysis and consequently is truly "collateral," noting that not all ESG factors are equal. Thus, in choosing among investments that would serve the financial interests of a plan equally well, an ESG factor that may not be economically material under the particular facts and circumstances may nonetheless be used to tip the scale. The fiduciary need not document this decision more extensively than any other investment decision, but under the 2021 Proposed Rule the collateral benefit characteristic must be prominently displayed in disclosure materials provided to participants when the tiebreaker concept is used in selecting a designated investment alternative in an individual account plan.

5. In the somewhat unrelated area of proxy voting, the DOL has worked to counteract perceived misperceptions the Trump administration's regulation on proxy voting (the "2020 Proxy Rule") may have fostered. Concerned that fiduciaries may take that regulation as permission to broadly abstain from voting proxies or that they should be indifferent to exercising shareholder rights, the DOL's 2021 Proposed Rule amends the investment regulation to align with the DOL's pre-2020 position. Specifically, the DOL:

   - Reaffirms that proxies should be voted as part of the process of managing a plan's investment, unless a plan fiduciary determines that voting proxies may not be in the plan's best interest because, for example, voting would involve significant expense or effort that outweighs the benefit to the plan of voting the shares. That is, the presumption is in favor of voting proxies, unless the costs outweigh the benefits.
   - Eliminates the statement from the 2020 Proxy Rule that the fiduciary duty to manage shareholder rights does not require the voting of every proxy or the exercise of every shareholder right. Not that, as the DOL explains, fiduciaries must always vote proxies or engage in shareholder activism.
   - Eliminates the special monitoring obligations when authority to vote proxies is delegated to an investment manager or proxy voting firm.
   - Removes the safe harbor examples permitting policies limiting voting to issues substantially related to the issuer's business activities or expected to have a material effect on the value of the investment, and to refrain from voting on proposals when the plan's holding is a relatively small percentage of the plan's assets.

- Eliminates the requirement to keep special records on proxy voting activities, lest a misperception linger that proxy voting is disfavored or carries greater fiduciary obligations than other fiduciary activities.
- Cross-references ESG factors in describing the fiduciary's duty to act solely in the economic interest of the plan, clarifying that ESG factors can also be relevant material economic factors in deliberations on shareholder rights.

ESG Interest and Options Are Growing

Plan participants' interest in ESG investing appears to be strong. A 2019 Cerulli study found that 56% of surveyed US plan participants show a preference for investing in companies that are both environmentally and socially responsible. The percentage increases to 63% among the plan participant population under age 40.[1] According to Robert "Emery" Pike, CFA, AIF®, who serves as the ESG lead on the Investment Committee of the Plan Sponsor Council of America (PSCA), "plan fiduciaries are becoming increasingly aware of ESG's growing prominence and preference by many participants, and they want to learn more."

Investment options that consider ESG factors have also grown over recent years, although estimates of ESG- related assets vary depending on the definition of an ESG investment. One study from the Investment Company Institute (ICI) finds that the number of US mutual funds and ETFs investing with an ESG focus has grown to over 500 as of December 2019, accounting for over $300 billion in assets across various areas of ESG interest, such as environmental impact, religious values, and broader ESG considerations.[2]

Other studies take a broader approach to estimating ESG-related investment. The US Forum for Sustainable and Responsible Investment (US SIF) produces a biennial report on ESG investment trends, accounting for assets that the organization confirms incorporate ESG criteria into investment analysis and selection—whether or not explicitly disclosed in offering documents—as well as strategies that involve filing shareholder resolutions on ESG issues. The most recent report from the US SIF, issued in 2020, estimated total assets in US-registered investment companies (such as mutual funds, exchange-traded funds, variable annuities, and closed-end funds) incorporating ESG criteria at $3.1 trillion, up 19% from the prior report in 2018.[3] The US SIF report also estimates ESG incorporation across other money manager asset categories and vehicle types, showing the ESG trend has reach beyond mutual funds. Top ESG criteria reported by money managers in the study included climate change considerations, tobacco, human rights, and transparency and anti-corruption.

While the studies from ICI and US SIF both suggest general growth in ESG uptake, the difference in asset levels between the studies reflects the reality that ESG investment takes many forms.

Considerations for Plan Fiduciaries Evaluating ESG Options

Critical to the assessment of investment options incorporating ESG considerations, as with any other material factors, is the impact of such considerations on expected returns and risk.

HOW CAN ESG CONSIDERATIONS IMPACT EXPECTED RETURNS?

There is a growing debate among academics and practitioners about whether ESG characteristics have a direct impact on expected returns. Some claim that companies with better ESG profiles have higher prices relative to peers and, as a result, offer lower expected returns. Others claim that investing in companies with better ESG profiles can lead to higher expected returns. Plan fiduciaries can benefit from an understanding of the growing literature on the link between ESG variables and expected returns.

Extensive research from the academic community on this topic, according to some, has so far not found compelling evidence that companies with strong ESG profiles have higher or lower expected returns than companies with poor ESG profiles after controlling for exposure to known drivers of expected returns, such as size, relative price, and profitability in equities and forward rates in fixed income. An important takeaway from this research is that, while an ESG variable may appear to contain information about differences in expected returns when evaluated in isolation, such a finding might not provide additional information beyond our existing understanding of expected returns.

This suggests plan fiduciaries should be cautious in evaluating the robustness of research presented to support an investment approach that selects securities based on ESG criteria. Similarly, plan fiduciaries should be cautious in evaluating the robustness of research suggesting that investors have to give up expected returns by selecting investment options that incorporate ESG considerations. Incorporating ESG considerations in an investment strategy does not require investors to accept lower expected returns. In fact, it can be reasonable for a prudent fiduciary to conclude that the issue is still open for debate, and may even be industry- or company- specific.

An approach that thoughtfully integrates ESG considerations in security selection and weighting while maintaining a focus on robust drivers of expected returns within a broadly diversified investment strategy can offer similar expected returns to a like investment strategy that does not have a dedicated ESG focus.

HOW CAN ESG CONSIDERATIONS IMPACT INVESTMENT RISK?

ESG risks should be considered as part of a robust risk management approach. An important tool for managing ESG-related risk is investment stewardship, which may also lead to higher returns for investors. Company boards should have the right expertise in place to manage material risks in accordance with shareholder interests. These risks can span the ESG spectrum, including risks related to environmental or social issues, such as climate change or child labor concerns. Once a company is held by a portfolio, stewardship activities, such as proxy voting, company engagement, and industry advocacy, aim to promote corporate governance practices and disclosure on material risks that may serve to protect or enhance shareholder value.

BEST PRACTICE

To add an ESG-themed investment to a participant directed investment plan:

- Survey plan participants and assess the level and areas of particular interest.
- Understand how potential investment managers use ESG criteria, including use of ESG factors for risk management.
- Review where and whether ESG options fit into the current investment lineup and whether the plan's Investment Policy Statement requires adjustment for ESG factors to be considered.
- Conduct (as always and as with any other material factors considered) solid diligence—make sure the investment is selected on the basis of material, economic considerations.

If governance practices at a portfolio company are improved from these efforts, this may lead to a higher share price through either greater expected future cash flows to investors or a lower discount rate applied by investors.

For example, executive compensation is an important governance issue. If compensation is excessive or not designed to align management interests with business strategy and shareholder interests, advocating for improved compensation policies may support improved shareholder value. If improved practices are realized, money that may have been directed toward executive compensation could instead increase cash flows to investors or lead to increased confidence that management is acting in the best interest of shareholders, both potentially improving shareholder value.

PRO TIP

ESG risks should be considered as part of a robust risk management approach.

While accounting for ESG risks in investment stewardship may serve to enhance risk management processes, it is also important to assess whether a strategy that selects securities based on ESG criteria can lead to a meaningful loss in portfolio diversification across securities, sectors, and, where applicable, countries. Care should be taken to ensure that ESG integration, such as a best-in-class approach that might seek to invest only in companies believed to have high positive impact on ESG issues, do not lead to concentrated solutions that lose out on important benefits of diversification in managing idiosyncratic risks and improving the reliability of investment outcomes through time. Guidance from the DOL is clear that plan sponsors should not select investment options that pursue ESG goals at the expense of such sound investment principles.

Additional Advice for Plan Fiduciaries

Fiduciaries that want to add an ESG option to the investment menu of a participant-directed account should:

- Survey plan participants and assess the level and areas of particular interest.
- Know how potential investment managers use ESG criteria, including use of ESG factors for risk management.
- Review where and whether ESG options fit into the current investment lineup and whether the Investment Policy Statement requires adjustment for ESG factors to be considered.
- Understand and select the specific ESG factors that can be used. Benchmarking can be challenging when, for example, one fund focuses on carbon emissions and another on corporate diversity.
- Understand how data on specific company practices is collected.
- Understand how the impact of a chosen strategy can be measured, reported, and defended, given that risk or return can never be sacrificed for non-economic social goods.

Final Word—For Now

Plan fiduciaries looking to meet the growing demand for ESG investments while adhering to their fiduciary duties need to make a careful assessment of the impact of ESG approaches, as with any approach, on expected returns and risk. The newly proposed ESG regulations DOL issued this year to counter the perception from the 2020 Trump administration ESG rule that ESG investing was somehow inherently suspect affirm that fiduciary responsibility may not only permit, but often in fact *require*, evaluation of the economic effects of climate change and other ESG factors on a particular investment or investment course of action. Remember that these are proposed regulations. Fiduciaries should continue to monitor the DOL's progress on finalizing these regulations to make sure they understand their obligations.

1. "The Cerulli Edge: US Retirement Edition—Trends to Watch in 2019," Cerulli Associates.
2. The Investment Company Institute, *The Investment Company Fact Book, 2020. icifactbook.org*. The ICI's study is based on an assessment of fund prospectus language and includes funds with an investment objective or principal investment strategy indicating an explicit emphasis on ESG criteria to achieve certain goals.
3. "US SIF Foundation Trends Report 2020 Executive Summary," US SIF.

Developed for Dimensional Fund Advisors by Ian S. Kopelman, partner at DLA Piper.

MKT-22848 04/22 1947086

Collective Investment Trusts

December 2020

KEY PRINCIPLES

Collective investment trusts carry key differences from other retirement plan investments–with important implications for fiduciaries, including the following:

1. Assets held in CITs, unlike those in publicly offered mutual funds, are considered plan assets under ERISA and are regulated by the DOL. That makes the bank trustee and any managers hired to invest the CITs ERISA fiduciaries, so both the corporate trustee and the advisors it hires may be liable under ERISA for imprudent investment of the underlying assets.
2. Unlike mutual funds, CITs are supervised by federal or state banking regulators, generally qualify for exemptions from the Securities Act of 1933, and are exempt from requirements to register as investment companies under the Investment Company Act of 1940.
3. Unlike mutual funds, CITs are typically tax-exempt as "group trusts" and must adhere to IRS rules to maintain that status.

ERISA fiduciaries are obligated to administer retirement plans in a manner that reduces expenses and maximizes assets to a reasonable extent. Plan sponsors and fiduciaries increasingly see collective investment trusts or funds (CITs) as a way to offer fee flexibility and white labeling opportunities and as a replacement for separate account mandates. As a result, retirement plan sponsors, fiduciaries, and advisors are expressing growing interest in these vehicles.

What Are CITs?

Collective investment trusts or funds (also called commingled trusts) are pooled investment vehicles maintained by a bank or trust company serving as a corporate trustee. CITs are not publicly traded but are instead exclusively available to a specific set of qualified retirement plans, such as 401(k) and other defined contribution (DC) and defined benefit (DB) plans (but not to IRAs, health savings accounts, or certain 403(b) plans of educational institutions). Also, money invested in a CIT is not guaranteed by the FDIC or any other regulatory authority even though the CIT is maintained by a bank or trust company.

CIT assets are invested in accordance with a trust document and any corollary descriptive documents. Like a mutual fund, each CIT generally has a specific investment objective and may be invested in a wide range of active or passive investments. These investments may include securities usually found in mutual funds as well as real estate investment trusts, commodities, hedge funds, private equity, and exchange-traded funds. CITs can be used in a fund-of-funds structure, such as target date or target risk funds. They may also be, and often are, used to implement qualified default investment alternatives (QDIAs) under the Pension Protection Act of 2006.

Available since 1927, CITs were traditionally used by DB plans engaged in stable value or passive strategies; purchases and withdrawals were processed manually, and CIT valuations occurred infrequently. However, since the early 2000s, technological advances have equipped CITs to operate, and be valued, more like mutual funds. Also, their number and availability across asset classes and strategies have greatly expanded. Recent surveys consistently show a substantial increase in the percentage of DC plans offering CITs. At the end of 2018, total retirement plan investment in CITs was reportedly $3 trillion, with a compound annual growth rate of 7.25% over the preceding five-year period.[1]

Developed for Dimensional Fund Advisors by Ian S. Kopelman, partner at DLA Piper.

All that said, CITs carry key differences from other retirement plan investments—with important implications for fiduciaries.

CITs vs. Mutual Funds

REGULATION

Unlike mutual funds, CITs are supervised by federal or state banking regulators, generally qualify for exemptions from the Securities Act of 1933, and are exempt from requirements to register as investment companies under the Investment Company Act of 1940.

Assets in CITs, unlike those in publicly offered mutual funds, are plan assets under ERISA and are thus regulated by the US Department of Labor (DOL). The bank trustee and any managers hired to invest the CITs are ERISA fiduciaries and held to ERISA fiduciary standards, including the ERISA prohibited transaction rules and the duty to act prudently and solely in the interest of the investing plan participants. This can also result in potential liability for other plan fiduciaries under the co-fiduciary liability rules described in the Fiduciary Foundations section of this guide.

CITs, unlike mutual funds, are typically tax-exempt as "group trusts." Thus, they must adhere to Internal Revenue Code rules to maintain that status, including the requirement that each investing plan adopt the terms of the CIT's group trust.

BEST PRACTICE

Fees can have a big impact on participants' returns, so plan sponsors are well served by periodically reviewing the plan's investments as well as alternative investment structures available to a specific plan.

COSTS

CITs generally will not have the same administrative and marketing costs as mutual funds, as they need not prepare prospectuses or the regulatory and compliance reporting required of mutual funds and do not service the public using call centers and other services. However, a CIT's recordkeeper often provides similar services and information, and these costs are typically part of the overall service fees charged to a plan (and its participants). These fees may or may not be included in the fund's daily net asset value (NAV).

Also, while CIT fees may be negotiable, mutual funds must charge the fees disclosed in their prospectuses.

FIDUCIARY STRUCTURE AND RESPONSIBILITIES

All of the underlying assets in a CIT, unlike those in mutual funds, are considered ERISA plan assets. This means:

1. The CIT trustee and its advisors are ERISA fiduciaries, so both the corporate trustee and the advisors it hires are liable under ERISA for imprudent investment of the underlying assets. (A mutual fund advisor is not an ERISA fiduciary but is subject to securities and common law requirements.)
2. Transactions with the potential for conflicts of interest (as statutorily defined in ERISA) are prohibited unless they fit within statutory exemptions or class or individual exemptions issued by the DOL. In addition to general exemptions, there are exemptions specific to CITs. Examples of potentially prohibited transactions include investments in securities of any investing plan sponsor or in proprietary products offered by the bank or trust company that maintains the CIT.

3. The plan investor is required to report the plan's pro rata share of each asset in the CIT on Form 5500, rather than merely reporting the aggregate investment in the CIT itself, as is the case with an investment in a mutual fund. (Many bank CIT sponsors handle this requirement for the investing plans by directly reporting the CIT holdings to the DOL.)
4. The corporate trustee's advisor is subject to ERISA bonding. (Trustees are generally exempt.)

AVAILABILITY OF PERFORMANCE DATA

Public information about CITs is limited, which means participants are not able to track the performance of a CIT investment the way they can with mutual funds. However, CIT trustees often provide fact sheets and daily financial information that participants may be able to access at the website of the plan or CIT trustee.

DOL regulations require sponsors of CITs to furnish plan fiduciaries with the kind of information needed to complete plan and participant disclosure obligations.

FEES

Since fees can have a big impact on participants' returns, plan fiduciaries should, while periodically reviewing the plan's current investments, also review alternative investments available to the plan. As in any ERISA fiduciary activity, process is key. The best defense against any allegation of a fiduciary breach is a record of appropriate deliberation leading to rationally based decisions.

Remember, a fiduciary isn't necessarily required to select the lowest-cost alternative or attain the highest returns as determined with hindsight. However, a fiduciary is required to exercise (and must be prepared to demonstrate) the prudent process used to select and retain the retirement plan's investments.

PRO TIP

Remember that a fiduciary isn't necessarily required to select the cheapest alternative or attain the highest returns as determined with hindsight. However, a fiduciary is required to exercise (and must be prepared to demonstrate) the prudent process used to select and retain the retirement plan's investments.

Checklist for CITs: Recommended Practices

Plan fiduciaries should engage in the usual due diligence. Here are seven key actions:

1. Read the declaration of trust, participation agreement, and any other related trust documentation carefully because important terms cannot be assumed. Unlike mutual funds, which have fairly uniform terms and features because they are highly regulated under securities laws, individual CIT terms can vary widely. The documentation controls what the CIT can invest in and how. Also, a specific CIT may allow redemptions only on a quarterly basis or impose lockup periods. Plan fiduciaries should consider any transfer restrictions the CIT may impose under ordinary circumstances in the event of a participant termination, or if the plan merges or terminates, and consider whether these restrictions will impede the normal operations of the plan or are even permitted under the plan's terms. As such, consider whether participant communications and even plan amendments will be required by these restrictions.

2. The investing plan document should explicitly permit investment in a CIT, or the investment should be authorized by a named fiduciary who is independent of the CIT trustee and has authority to direct plan investments.
3. Understand and analyze fees for reasonableness, and test whether fees and investment minimums are negotiable. As with publicly traded mutual funds, CITs can have multiple share classes or fee schedules; fiduciaries should consider these various structures when selecting (or monitoring) an investment.
4. Learn what kind of performance information is available to participants. (Performance data may be available through the recordkeeper or the trustee/manager, and Morningstar offers some CIT details.)
5. Plan fiduciaries that select a CIT investment have at least some fiduciary responsibility over the assets of the CIT and the CIT's fiduciaries, due to the fact that under ERISA, the assets of the CIT are deemed to be assets of the investing plans. As such, plan fiduciaries have oversight responsibility over CIT investments and co-fiduciary liability for the CIT fiduciary's actions under the ERISA co-fiduciary liability rules described earlier in this guide.
6. Find out whether the trustee reports the CIT's assets directly to the DOL; if so, under current rules, the plan may not need to report its pro rata share of all of the CIT assets on its Form 5500.
7. Obtain the CIT's IRS determination letter indicating the CIT is a group trust, or otherwise confirm the CIT's tax-exempt status.
8. Ask about reliance on the prohibited transaction exemptions, and obtain assurance that any conditions are met.

1. "CITs Offer Major Cost Advantages, but Education and Transparency Will Be Essential," Cerulli Associates (August 2019).

Safeguarding Plan Assets and Cybersecurity

December 2020

KEY PRINCIPLE

While legislative, regulatory, and judicial actions to date have been insufficient to define the dimensions of fiduciary duties related to cybersecurity, the careful fiduciary will understand these duties to include a responsibility to be familiar with and guard against cyberattacks that may result in the theft of participant accounts or the compromise of sensitive personal data.

Although cybersecurity can be implemented by many parties associated with a retirement plan, responsibility for cybersecurity usually rests with the plan fiduciary. Often delegated or assigned by contract, the actions by service providers, such as advisors, recordkeepers, or third-party administrators, should be monitored for compliance with cybersecurity rules, regulations, and best practices.

Below, we are pleased to highlight how the Centre for Fiduciary Excellence (CEFEX) addresses cybersecurity when reviewing investment advisors for the CEFEX Investment Advisor designation. These questions, principles, and practices are based on the National Institute of Standards and Technology's cybersecurity framework[1] and, therefore, may be applicable to plan sponsors and other service providers alike. (The Center for Fiduciary Excellence is a global fiduciary certification organization. CEFEX-certified firms voluntarily undergo annual audits by independent expert analysts to continually verify the firms' adherence to the applicable standards. These audits are supplemental to oversight performed by regulators or financial auditors.)

Rule 30 under the US Securities and Exchange Commission's Regulation S-P states: "Every broker, dealer, and investment company, and every investment advisor registered with the commission, must adopt written policies and procedures that address administrative, technical, and physical safeguards for the protection of customer records and information. These written policies and procedures must be reasonably designed to:

1. Insure the security and confidentiality of customer records and information.
2. Protect against any anticipated threats or hazards to the security or integrity of customer records and information.
3. Protect against unauthorized access to or use of customer records or information that could result in substantial harm or inconvenience to any customer."

Developed for Dimensional Fund Advisors by Ian S. Kopelman, partner at DLA Piper.

BEST PRACTICE

Several independent and authoritative organizations have developed frameworks to help organizations (1) assess their cybersecurity capacity and vulnerabilities and (2) establish and develop cybersecurity programs. These frameworks—including the American Institute of Certified Public Accountants' Trust Services Criteria, the National Institute of Standards and Technology's Cybersecurity Framework, and the International Organization for Standardization's standard on Information Security Management Systems—provide guidance on administrative, technical, and physical safeguards designed to help enterprises identify, protect against, detect, respond to, and recover from cybersecurity events.

When assessing an investment advisor, CEFEX asks the following questions:

1. *Does the advisor physically hold and store any personally identifiable information (PII)?*
   Client, participant, or plan data may include PII, which includes any kind of information regarding an individual, i.e., Social Security number (SSN). The SSN may be stored as client artifacts written in application documents. An example of physical data security would be storage in immobile file cabinets in a locked room with only two named individuals having access to the room. A key fob system logs every entry into the room.

2. *Does the advisor hold and store PII in electronic formats?*
   Electronic formats include database systems, drives, removable media, and backup media. If the answer is yes, comments should include the type of PII stored, the method in which it is stored, and how each method is secured.

3. *Does the advisor have guidelines for accessing electronic applications?*
   Guidelines should include:

   a) Complex password schemes, such as:

      i) the password is at least eight characters long.

      ii) the password contains characters from at least three of the following four categories:

         - English uppercase characters (A–Z)
         - English lowercase characters (a–z)
         - Base 10 digits (0–9)
         - Non-alphanumeric (for example: !, $, #, or %)

      iii) the password does not contain three or more characters from the user's account number or username.

   b) The use of an SSN or any other PII as the username to access internet-based applications is prohibited. It is recommended as a best practice, but not prohibited, to avoid using email addresses as usernames.

   c) Ideally, multifactor authentication is used in remote access situations.

4. *Does the advisor have a policy regarding the storage, transmission, and disposal of participant or plan data?*
   Examples of how client, participant, or plan data is secured while in transit include secure fax, secure messaging service, etc. Does the advisor have data protocols for remote employees (e.g., restricting the printing of any PII)?

5. *Is PII encrypted at the server level?*

6. *Is PII encrypted when sent by email?*

7. *Have background checks been completed on staff who have access to client, participant, or plan data?*
8. *Does the advisor have a document retention policy?*
   A policy would describe how long data is retained and the circumstances under which it should be disposed, including document shredding capabilities and practices.
9. *Does the advisor have a process for backing up client, participant, or plan data?*
10. *Does the advisor's facility have security controls in place (e.g., camera, keyless entry, etc.)?*
11. *Does the advisor have an information security process for employment terminations?*
12. *Does the advisor have a procedure for handling security breaches?*
    A breach could include the accidental dissemination of PII, the discovery of a computer hacker attack, or a physical location break-in. The procedure should include a description of how breaches are handled, including how affected parties should be notified. Does the plan comply with state privacy laws?

HELPFUL LINKS:

SEC guidance on cybersecurity (November 2015).

"*Cybersecurity Considerations for Benefit Plans*," a report to the US Department of Labor by the CEFEX Advisory Council on Employee Welfare and Pension Benefit Plans (November 2016).

Harvard Law School article describing the SEC's sanction of an investment advisor for inadequate cybersecurity (October 2018).

"*Report on Cybersecurity Practices*," by FINRA, a reference on industry practices (December 2018).

"US Department of Labor Issued Cybersecurity Guidance for Plan Sponsors, Plan Fiduciaries, Recordkeepers, and Plan Participants," news release (April 2021).

PRO TIP

Fiduciaries should monitor regulatory actions and litigation to understand how cybersecurity expectations for retirement plans are evolving. For example, a lawsuit filed in October 2019—which was settled in March 2020—by a participant in the retirement plan of Estée Lauder may provide valuable insights. In this case, the plan participant's 401(k) account was effectively stolen and used to make unauthorized electronic distributions. The participant sued Estée Lauder Inc., the Estée Lauder Inc. Employee Benefits Committee, Alight Solutions LLC (the recordkeeper), and State Street Bank and Trust Co.

1. Cybersecurity Framework," NIST, *nist.gov/cyberframework*.

MKT-8783 12/20 1777948

Guidance for Employers Offering HSAs

December 2020

KEY PRINCIPLES

1. By observing minimal guidelines, an employer can offer HSA accounts without establishing an ERISA plan, significantly reducing the compliance obligations and mitigating the fiduciary risks.
2. Regardless of ERISA plan status, the employer remains subject to the prohibited transaction rules of the Internal Revenue Code.

Health savings accounts (HSAs) have become increasingly popular since they were created in 2003, with assets totaling a reported $61.7 billion as of June 30, 2019.[1] Many employers offering group health plans now offer HSAs to help employees pay for medical expenses not covered by high-deductible health plans (HDHPs). Available only to employees with no health insurance other than an HDHP, these individually owned, fully vested accounts also allow tax-favored funds to accumulate over many years, making HSAs attractive long-term savings vehicles.

Given these basic attributes, two overarching fiduciary considerations arise:

1. By observing minimal guidelines, an employer can offer these accounts without establishing an ERISA plan and significantly reduce the compliance obligation and concurrent risk of compliance failures.
2. Even though ERISA may not apply, the employer remains subject to the prohibited transaction rules of the Internal Revenue Code. So it would nonetheless be wise to incorporate an ERISA standard of care in operating the program, including the selection and monitoring of the provider and investment opportunities for employees.

Offering HSAs without ERISA: Why That May Matter

If the HSA program is not treated as an ERISA plan, the employer is not an ERISA fiduciary and thus not held to the exacting ERISA prudence and loyalty duties.[2] Further, compliance obligations are significantly reduced. The employer need not file Form 5500 and annual summary reports nor prepare an ERISA-compliant plan document, provide a summary plan description, adopt a claims procedure, offer COBRA coverage, or comply with HIPAA portability or nondiscrimination rules. Neither do disputes need to be adjudicated in federal court.

Establishing and Maintaining Non-ERISA Plan Status

The US Department of Labor (DOL), the federal agency with ERISA regulatory and enforcement authority, has stated that HSAs generally will not constitute employee welfare benefit plans (ERISA plans) if employer involvement with the HSA is limited—even though the accounts may be associated with an HDHP, which will almost certainly

Developed for Dimensional Fund Advisors by Ian S. Kopelman, partner at DLA Piper.

be an ERISA plan. The DOL has published guidance that is helpful in defining that limited involvement.[3] These guidelines essentially require the following:

1. The employer may not:
   - Limit the ability of employees to roll their funds over to a different HSA (beyond Code restrictions).
   - Impose conditions on using funds, which would include communicating that HSA distributions can only be used for medical expenses.
   - Make or influence investment decisions.
   - Represent that the HSAs are an employee welfare benefit plan established or maintained by the employer. Information about the HSA program will likely be communicated with details about other programs that definitely are ERISA plans. So language is crucial in distinguishing the HSAs. An explicit statement that the HSA program is not subject to ERISA is also suggested.
   - Receive any payment or compensation in connection with the HSA, including a discount on another product from the vendor. The DOL explains, though, that contributions could be made through a cafeteria plan, and the resulting employer savings in FICA and FUTA taxes would not constitute such "payment or compensation."
2. The employer may:
   - Limit the HSA providers it allows to market products in the workplace or select a single provider to which it will forward contributions through its payroll system.
   - Select an HSA carrier that offers limited investment options or options that replicate those in the employer's 401(k) plan.
   - Contribute to the HSA or pay fees that employees would otherwise be required to pay.
   - Provide general information on the advisability of using an HSA in conjunction with the HDHP.
3. Finally, the employee's decision to contribute, through salary reduction or otherwise, must be completely voluntary. (As to employer contributions, the employer could establish accounts and contribute without employee consent and still not negate this voluntary requirement.)[4]

BEST PRACTICE

Even if the HSA is not an ERISA plan, an employer would be wise to incorporate an ERISA standard of care in operating the program, including the selection and monitoring of the provider and investment options.

No Avoiding Internal Revenue Code

The Internal Revenue Code, like ERISA, prohibits specified transactions considered conflicts of interest, and these prohibited transaction rules apply to HSAs. An employer could carefully maintain a non-ERISA program and still run afoul of these rules, which carry excise taxes. In the HSA context, a likely trouble spot is the transmission of employee contributions. A failure to transmit these contributions promptly to the HSA trustee or custodian will violate the prohibited transactions rules.

Some Form of Due Care Required

In addition to the Code's prohibited transaction provisions, a non-ERISA HSA program is subject to state laws, which would be preempted in the context of ERISA-covered plans. Without the uniformity of ERISA, an employer's operation of its HSA program can be subject to any number of different state laws, such as codified trust or fiduciary law or the common law of trusts; an employee claim could be based on contract law or negligence.

It's wise to assume that decisions affecting employee funds must be made with care. For example, a Wisconsin court of appeals grafted an ERISA-like standard of care on to the administration of a non-ERISA 403(b) plan, finding the school district would be liable for losses "if it failed to use the degree of care, skill, and judgment that reasonably prudent administrators would exercise under like or similar circumstances."[5]

As such, an employer would be well served by treating the HSA program with no less care than its ERISA plans. Using and documenting a responsible process for choosing and monitoring a provider gives the employer a defensible position. Factors for consideration:

1. Review and compare fees. Fees may be charged for account opening, account maintenance, specific transactions, etc., which vary widely among vendors. Insist that fees be clearly stated.
2. Determine whether the vendor provides investment options or self-directed accounts. (The DOL has stated that a single investment option is not reasonable.)
3. If investment options are offered, rather than a self-directed account, understand the options, how they were selected, their relative expenses, their share class, and the adequacy of the array.
4. Know who earns revenue on the investments and in what amount.
5. Understand how and where funds will be held. If the provider is not a bank, how does it select banks or insurance companies to place funds? Are funds FDIC-insured? Are they held in separate accounts or commingled?
6. Thoroughly review vendor qualifications as well as any employee satisfaction data.

In short, employers can limit their compliance obligations when setting up HSAs that help their HDHP-covered employees achieve tax-favored health care payment and savings goals. But employers must be careful how they go about it.

PRO TIP

The US Department of Labor has stated that HSAs generally will not constitute employee welfare benefit plans (ERISA plans) if employer involvement is limited and published guidance is helpful in defining that limited involvement.

Background:

- *dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2004-01*
- *dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2006-02*

1. "2019 Midyear Devenir HSA Research Report," Devenir Research, August 2019, *devenir.com/research/2019-midyear-devenir-hsa-research-report/*.
2. If an HSA program is an ERISA plan, the extent to which the employer is consequently a fiduciary depends on the employer's stated and functional roles. That is, the employer is a fiduciary if named in plan documents as the administrator or named fiduciary or if it functions as a fiduciary by, for example, selecting the HSA provider.
3. "Field Assistance Bulletin No. 2004-01," US Department of Labor, *dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2004-01*; "Field Assistance Bulletin No. 2006-02," US DOL, *dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2006-02*.
4. In addition to these guidelines, an employer that does not intend to contribute to employee HSAs could avoid ERISA plan status by conforming to the group-type insurance program safe harbor set out in DOL regulation 29 C.F.R. 2510.3—1(j), in which the program is voluntary and not contributed to or endorsed by the employer.
5. Ann Cattau v. Natl. Insurance Services of Wisconsin, Inc. et al. 2015 WI APP 40 (Ct. App. Wisc.20).

MKT-8783 12/20 1777948

Dimensional

APPENDIX

Sample Investment Policy Statement for a 401(k) Plan

December 2020

An investment policy statement (IPS) is a written document designed to assist plan fiduciaries by providing a general framework for plan investment decisions. Maintaining an IPS designed to further the purposes of the retirement plan is consistent with the fiduciary obligations set forth under the Employee Retirement Income Security Act of 1974 (ERISA) and can be an important legal document when demonstrating a plan fiduciary's commitment to the fiduciary's obligations.

The following sample IPS is being provided by Dimensional Fund Advisors LP (Dimensional) as a resource available to financial advisors to use with their plan sponsor clients. The sample IPS is not a one-size-fits-all template. Advisors will need to customize the final version of the IPS based on the plan's unique provisions. Without customization and significant modifications, the sample IPS will not fit a plan's situation.

The sample IPS and any materials accompanying it are provided for general and educational purposes only and are not intended to provide legal, tax, or investment advice. Further, the sample IPS and any accompanying materials are not intended to and do not provide fiduciary recommendations concerning investments or investment management and should not be relied upon as such. Any examples used are generic, hypothetical, and for illustration purposes only. Neither Dimensional nor its affiliates or representatives, nor Mr. Kopelman, are suggesting that any person take a specific course of action or any action at all. It is up to the financial advisor to include any appropriate disclaimers when sharing the sample IPS with clients.

We strongly recommend that plan sponsors also consult with a qualified legal counsel or advisor on the legal and tax implications of creating an IPS and reviewing its terms, as well as any applicable investment advisors retained to provide services to the plan, before final adoption. Neither Dimensional nor its affiliates or representatives, nor the author, are responsible for the legal and tax aspects of using an IPS or the appropriateness of any IPS or its provisions to a plan sponsor's situation.

Developed for Dimensional Fund Advisors by Ian S. Kopelman, partner at DLA Piper.

Sample Investment Policy Statement for a 401(k) Plan

PLAN COMMITTEE POLICY STATEMENT FOR:

_____ Plan

Plan Name: _____

Type of Plan: _____

Plan Adoption Date: _____

Plan Year-End Date: _____

Plan Number: _____

STATEMENT OF PURPOSE

This Policy Statement has been adopted by the Plan Committee under the _____ Plan (the "Plan Committee") to provide guidelines for the investment and management of funds held in trust for the benefit of participants in and beneficiaries of ("participants") the _____ (the "Plan").

Investments of Plan assets will be made for the sole interest and exclusive purpose of providing benefits to participants and beneficiaries of the Plan. The Plan Committee aims to provide the tools, investment options, and services in order to help participants accumulate retirement assets and/or seek to achieve their retirement income goals.

RESPONSIBLE PARTIES

Among the parties responsible for the management and operation of the Plan are:

Plan Sponsor: _____

Trustee: _____

Plan Administrator: _____

ROLE OF THE PLAN COMMITTEE

The Plan Committee will:

- Establish and maintain this Policy Statement;
- Provide participants with information about the Plan;
- [Research, select, offer, and withdraw (as needed) specific funds as deemed appropriate by the Plan Committee for identified asset classes;]
- Seek to manage and control non-investment related costs of the Plan;
- Review reporting on the financial operations of the Plan, including on the processing of contributions, distributions, proxy voting, payment of expenses, and other administrative matters;
- Make recommendations, from time to time, to management of the plan sponsor regarding employer contributions, including any conditions for potential employer matching contributions if applicable;
- Recommend to the plan sponsor the appropriate entity or person to pay for expenses of the Plan; and
- Meet on a periodic and on an as-needed basis.

PLAN PURPOSE AND OBJECTIVES

The plan sponsor has established the Plan to provide employees with a vehicle to assist participants in their aim to accumulate retirement assets and seek to achieve their retirement income goals. It is intended to be operated in accordance with all applicable federal laws and regulations. The Plan is subject to Department of Labor and Internal Revenue Service reporting requirements.

If the Plan intends to satisfy ERISA section 404(c), the following may be added:
The plan sponsor intends that the Plan satisfy the provisions of Department of Labor regulations issued pursuant to ERISA section 404(c), which may provide plan fiduciaries with relief from liability for the investment decisions made by Plan participants.

This is a participant-directed plan.

Participants may select their allocations and investments from a broad array of investment options offered under the Plan. Because of the varying nature of participants' investment goals and other retirement assets, the Plan offers a broad range of investment options to enable participants to create an investment portfolio appropriate for their own needs, including their individual risk diversification goals.

The objectives of the Plan include:

- Providing participants with an opportunity to accumulate retirement assets and to help them to achieve their retirement income goals;
- Obtaining Plan services and investment options at reasonable cost;
- Controlling overall Plan costs;
- Encouraging a high participation and savings rate;
- Selecting and monitoring investment options that support the attainment of the Plan's objectives; and
- Attracting and retaining high-quality employees for the plan sponsor.

Optional: BENCHMARKS OF PLAN SUCCESS

In assessing the overall success of the Plan, in conjunction with the performance of the investment options, the following benchmarks will be considered, subject to update from time to time as determined by action of the Plan Committee:

- Overall participation rate
- Average deferral rate

EMPLOYEE DEMOGRAPHICS

In addition to being guided by the Plan's purpose and objectives, the Plan Committee may consider the demographics of the eligible participant population in order to manage the Plan effectively.

INVESTMENT SELECTION AND MONITORING PROCESS

The monitoring of investments may be a regular process. While frequent change is neither expected nor necessarily desirable, the process of monitoring investment performance relative to specified guidelines is an ongoing process.

The Plan Committee will make its determination as to appropriate investment options to make available under the Plan with reference to the above-stated Plan purposes and objectives. When considering or reviewing investment options under the Plan, the Plan Committee expects to review various factors, as well as other factors deemed relevant by the committee from time to time, including investment performance, Plan benchmarks, fees and expenses, client service, manager reputation, diversified nature of the investment options, participant requests, and such other factors as the Plan Committee deems appropriate. The Plan Committee will not select a Fund solely on the basis of the lowest expenses and fees.

The Plan Committee will periodically review current investment options available under the Plan.

Optional: INVESTMENT ADVISOR

The Plan Committee is responsible for selecting, monitoring, and evaluating the performance of service providers retained to perform services on behalf of the Plan. The Plan Committee may retain an investment advisor to act as a "fiduciary" to the Plan, as such term is defined in section 3(21) of ERISA. The investment advisor should be an objective, third-party professional retained to assist the Plan Committee in managing the overall investment process.

CURRENTLY AVAILABLE FUND OPTIONS

The Plan Committee shall determine which funds are offered in the Plan lineup based on the process described above and may review and change these options at any time at its discretion.

Optional: INVESTMENTS FOCUSED ON POST-RETIREMENT INCOME

The Plan Committee recognizes that it may be in the interests of plan participants to have access to investments that consider income in retirement, such as target date funds or annuities if in fact annuities are permitted under the terms of the plan. Accordingly, the Plan Committee may evaluate and select appropriate funds that meet these goals as a potential option for participants.

Optional: DEFAULT OPTION

Defined Contribution plans may, but need not, provide that, to the extent a participant fails to direct the investment of assets in his or her individual account in the Plan, those assets are directed to a particular investment fund held by the plan. If that fund meets certain requirements, the fund is known as a Qualified Default Investment Alternative and default investments in that fund will not subject plan fiduciaries to liability under the ERISA co-fiduciary liability rules. The Plan Committee intends that such investment shall comply with applicable requirements of ERISA regarding qualified default investment alternatives.

PARTICIPANT COMMUNICATIONS

Participant communication materials, including fund prospectuses, will be available from the plan sponsor upon request or as otherwise required by applicable law and regulation.

(Optional) Each paragraph below may be included if permitted and authorized under the plan:

FURTHER GUIDELINES

Mutual Fund Investment Windows

To provide additional investment flexibility, a mutual fund investment window option may be offered as a way of providing additional investment options to Plan participants. If applicable, the Plan Committee is expected to review from time to time the window provider for reasonable cost, fund availability, competitive service capability, and participant satisfaction.

Self-Directed Brokerage

To provide additional investment flexibility, a self-directed brokerage option may be offered in the Plan. The Plan's self-directed brokerage option allows participants to invest in publicly traded securities, including stocks, bonds, and mutual funds, with the following exceptions: short sales, options, futures, limited partnerships, currency trading, and trading on margin. If applicable, the Plan Committee is expected to review from time to time the self-directed option provider for reasonable cost, competitive service capability, and participant satisfaction.

This Investment Policy Statement shall remain in effect until revised or amended by the Plan Administrator.

_____

Plan Administrator

_____

Date

MKT-8783 12/20 1777948

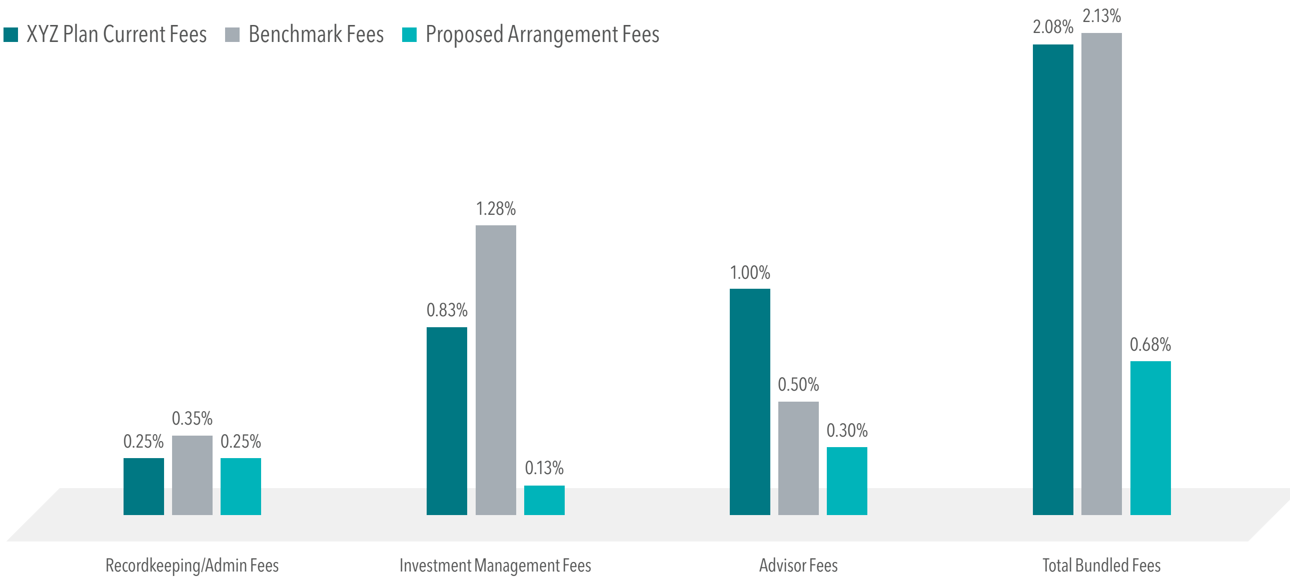
Plan Design and Fee Benchmarking Template

Plan Design—Benchmarking

Feature	Your Plan	Benchmark
Eligibility	One Month of Service	Immediate: 51% Three Months: 16% 6 months: 2% One Year or More: 31%
Max. Deferral	50%	76%
Per-Dollar Match	100% on First 3% of Pay Deferred, Plus 50% on Next 3% of Pay Deferred	65%
Max. Deferral Matched	8%	6%
Vesting Schedule	Immediate	Immediate: 36% 5 or 6 Year Graded: 33% Other: 31%
Loans	Yes	Yes: 85% No: 15%
Hardship Withdrawals	Yes	Yes: 82% No: 18%
Default Investment Option	Yes—Age-Appropriate Target Date Retirement Income Fund	Yes—Lifecycle Fund: 83% Yes — Other: 17%
Investment Options	44 Funds	21 Funds
Lifecycle Funds Offered	Yes	Yes: 89% No: 11%
Roth Contributions	Yes	Yes: 64% No: 36%
Safe Harbor Plan	Yes, Partial	Yes: 33% No: 67%

Source: Dimensional Fund Advisors

Fee Benchmarking Summary



Investment Fund Cost Analysis

Allocation		Current Weighted Avg. Expense Ratio: 0.83%			Proposed Weighted Avg. Expense Ratio: 0.13%		
Plan Assets	% of Assets	Current Funds	Expense Ratio	Cost	Proposed Funds	Expense Ratio	Cost
$150,000	3.00%	XYZ Fund	1.00%	$1,500.00	XYZ Fund	0.13%	$570.00
$350,000	7.00%	XYZ Fund	0.75%	$2,625.00	XYZ Fund	0.13%	$1,330.00
$150,000	3.00%	XYZ Fund	1.00%	$1,500.00	XYZ Fund	0.13%	$570.00
$350,000	7.00%	XYZ Fund	0.75%	$2,625.00	XYZ Fund	0.13%	$1,330.00
$150,000	3.00%	XYZ Fund	1.00%	$1,500.00	XYZ Fund	0.13%	$570.00
$350,000	7.00%	XYZ Fund	0.75%	$2,625.00	XYZ Fund	0.13%	$1,330.00
$150,000	3.00%	XYZ Fund	1.00%	$1,500.00	XYZ Fund	0.13%	$570.00
$350,000	7.00%	XYZ Fund	0.75%	$2,625.00	XYZ Fund	0.13%	$1,330.00
$150,000	3.00%	XYZ Fund	1.00%	$1,500.00	XYZ Fund	0.13%	$570.00
$350,000	7.00%	XYZ Fund	0.75%	$2,625.00	XYZ Fund	0.13%	$1,330.00
Total Plan Assets $2,500,000				$20,625.00			$3,250.00

Source: Dimensional Fund Advisors

All-In Cost Analysis

Service Provider Breakdown	Current Fee Arrangement	Current Fees ($)	Proposed Fee Arrangement	Proposed Fee Arrangement ($)
Annual Recordkeeping/Admin	0.25% of total plan assets	6,250.00	0.25% of total plan assets	6,250.00
Annual Investment Management	0.83% of total plan assets	20,625.00	0.13% of total plan assets	3,250.00
Annual Advisor Services	1.00% of total plan assets	25,000.00	0.30% of total plan assets	7,500.00
All-In Fees		51,875.00		17,000.00

Summary of Plan Services

- Investment Policy Development
- Fund Menu Consulting
- Plan Design Consulting
- Role as Investment Fiduciary [3(21) or 3(38)]
- Vendor Fee/Service Review
- Asset Allocation Model Construction
- Investment Monitoring
- Education Program Strategy
- Employee Meetings
- Quarterly Investment Reviews

MKT-8783 12/20 1777948

Fiduciary Education, Training, and Certification Resources

December 2020

CONTACT:
Carlos Panksep, VP, CEFEX
(416) 693-9733
carlos.panksep@fi360.com
fi360.com/cefex

The following is a representative list provided by certain service providers and is not intended to be a comprehensive list of the providers of those services. Neither Dimensional Fund Advisors nor Mr. Kopelman endorse, recommend, or guarantee the services discussed herein. The descriptions of each organization and service described below have been provided by the organization itself.

Fi360, Inc.

According to Fi360, now part of Broadridge Financial Solutions, Inc., it is a fiduciary education, training, and technology company. Since 1999, the firm's intent is to provide financial professionals with the tools necessary to act as a fiduciary in their work with investors. Headquartered in Pittsburgh, Pennsylvania, Fi360 is the home of the Accredited Investment Fiduciary® (AIF®) designation; the Fiduciary Focus Toolkit™; the Fi360 Fiduciary Score®; and CEFEX, Centre for Fiduciary Excellence.

CEFEX CERTIFICATION OVERVIEW: CEFEX certification of a firm or organization is achieved by successfully completing a fiduciary assessment. The CEFEX assessment is based on the standard "Prudent Practices for Investment Advisors." CEFEX states that it uses an ISO-like methodology, which includes data collection, interviews with key personnel, sampling of client files, and an on-site visit. The annual evidence-based assessment is intended to verify that the advisor has the processes and procedures in place that adhere to the standard. A CEFEX-certified firm is entitled to use the CEFEX® mark, a news release, a letter of registration, a legal opinion, a public listing on the CEFEX website, and the publicly available Independent Assessment Report.

AIF® CERTIFICATION OVERVIEW: Accredited Investment Fiduciary® (AIF®) designation training is intended to provide investment professionals with the fiduciary knowledge and tools to serve their clients' best interests. Advisors who complete the training are eligible to earn the AIF® designation to enable them to demonstrate the added value they bring to prospective and existing clients. The capstone course is a combination of online and classroom training with an exam administered at the end of the classroom portion. Capstone classes are hosted throughout the year and across the country. The self-paced online course is available on demand and should be completed within 90 days of purchase. The exam is administered online in coordination with a proctor.

CONTACT:
(703) 516-9300
customercare@psca.org
psca.org

The Plan Sponsor Council of America

The Plan Sponsor Council of America (PSCA), an affiliate organization of the American Retirement Association, is dedicated to helping improve Americans' retirement. Since its founding in 1947, PSCA has been on the forefront of protecting the American retirement system. Today, PSCA assists plan sponsors that are responsible for retirement plans serving millions of plan participants and provides its members with programs and services to help them better manage their company's retirement plans.

TRAINING/EDUCATION/CERTIFICATION OVERVIEW: The PSCA Certified Plan Sponsor Professional (CPSP) Credential™—developed by plan sponsors and some of the nation's leading retirement experts—provides plan sponsors with unique proof of their knowledge and skill in one of the nation's most challenging professions. Through the CPSP™, plan sponsors can improve and enhance their understanding of how to effectively evaluate, design, implement, and manage a comprehensive employer-sponsored retirement plan. Leveraging the latest in online education technology, the rigorous curriculum ensures plan sponsors have the knowledge they need to protect their organization from fiduciary risk and help secure their plan participants' retirement success.

The Fiduciary Formula

The Fiduciary Formula: 6 Essential Elements to Create the Perfect Corporate Retirement Plan, a book written by Josh Itzoe, (the 2018 PLANSPONSOR Retirement Plan Adviser of the Year), is intended to be a simple, easy-to-understand guide that helps retirement plan fiduciaries understand their responsibilities and navigate the complexities of ERISA. It covers everything from fiduciary governance, plan design, fees, and investments to participant support, financial wellness, and provider management. *The Fiduciary Formula* is a comprehensive guide that will help advisors continuously improve outcomes for plan sponsors and plan participants. Learn more at *fiduciaryu.com*.

ERISA Fiduciary Training

This comprehensive course was created by Josh Itzoe of Greenspring Advisors (the 2018 PLANSPONSOR Retirement Plan Adviser of the Year) and in consultation with Fred Reish from Faegre Drinker. It is designed to help retirement plan fiduciaries have a full understanding of what it means to be an ERISA fiduciary and to become better prepared to face their duties and manage both the corporate and personal liability that has arisen due to increased scrutiny from the US Department of Labor and the rapidly growing number of 401(k) and 403(b) lawsuits in the marketplace. With 24/7 access, this self-paced course includes 10 video lessons, 11 interactive quizzes, 13 compliance tips, and is eligible for 2.5 hours of CFP® and AIF® credit. Learn more at *fiduciaryu.com*.

MKT-8783 12/20 1777948

Dimensional

GLOSSARY

Glossary

Automatic Enrollment
A 401(k)-plan design feature in which a certain percentage or dollar amount of an eligible employee's compensation is automatically deferred—unless the employee designates a different amount or affirmatively elects not to contribute (also known as a negative election).

Beneficiary
The person to whom all or a portion of a deceased participant's retirement benefit is payable.

Collective Investment Trust (CIT)
A vehicle in which assets of qualified plans, often sponsored by unrelated employers, are pooled for investment purposes. CITs are often managed by banks or trust companies.

Contributions
Contributions made by an employee or employer to a qualified plan. Retirement contributions can be pretax or after tax.

Declaration of Trust or Trust Agreement
A legal document appointing a trustee to oversee assets being held for the benefit of others. The agreement also provides for the accumulation and disposition of trust assets, as well as their investment while held in the trust.

Defined Benefit Plan
A retirement plan that promises a specific predetermined benefit at retirement, usually defined by a formula with reference to factors such as salary and years of service. Since the benefit is not determined by allocated contributions and investment earnings as in a defined contribution plan, the sponsor—not the employee—bears the investment risk.

Defined Contribution Plan
A type of retirement plan in which a participant's benefits are based solely on the value of the participant's account balance; the value of that account balance depends on the level of employer and employee contributions and the earnings on those contributions.

Eligible Employee
Any employee who is eligible to become a participant in the plan pursuant to the terms of the plan document.

Employee Benefit Plan
The term "employee benefit plan" or "plan" means an employee welfare benefit plan or an employee pension benefit plan or a plan that is both an employee welfare benefit plan and an employee pension benefit plan.

Employee Retirement Income Security Act of 1974 (ERISA)
An act of Congress encompassing both Internal Revenue Code provisions that determine, in part, when a plan is tax qualified, and US Department of Labor (DOL) provisions, which govern the rights of participants and beneficiaries and the obligations of plan fiduciaries.

Employer Matching Contributions
An employer contribution plan that is linked to an elective deferral contribution by employees or, less typically, an after-tax employee contribution. For example, an employer might match elective contributions up to 50 cents on the dollar up to 6% of employees' base pay. (Also known as a Matching Contribution.)

ERISA 3(16) Administrator

The person or company designated by the terms of the plan to serve as plan administrator. The plan sponsor is the administrator in the absence of any such designation. The plan administrator's duties may include many tasks needed in managing the day-to-day operation of the plan. Administrator duties may be delegated to individuals or committees or to third parties. Many plan sponsors hire recordkeepers or third-party administrators. In such cases, it is important to clarify contractually the specific duties delegated and whether the administrator is assuming fiduciary responsibility for the performance of those duties.

ERISA 3(21) Fiduciary

Under ERISA 3(21), a person is defined as a fiduciary to the extent that he or she (1) exercises any discretionary authority or control over the management of a plan or the management or disposition of its assets, (2) renders investment advice for a fee or other compensation with respect to the funds or property of a plan or has the authority to do so, or (3) has any discretionary authority or responsibility in the administration of a plan. "ERISA section 3(21) fiduciary" may also be used to refer to an investment advisor who is responsible for the quality of advice and recommendations offered, agrees to apply a fiduciary standard, and is thereby subject to certain responsibilities (i.e., solely in the interest, prudence, and exclusive purpose), but serves in an advisory capacity and not as ultimate investment decision maker. Plan sponsors should be sure to understand and clarify the duties to be performed and fiduciary responsibility assumed by any advisor.

ERISA 3(38) Investment Manager

Any fiduciary (other than a trustee or named fiduciary) who has the power to manage, acquire, or dispose of plan assets; is either a registered investment advisor under the Investment Advisers Act of 1940, a bank, or an insurance company; and has acknowledged its fiduciary status in writing to the plan. The fiduciary acts as the investment manager with discretionary authority that may extend over all of the assets of the Plan, or only part of the Plan's assets, or alternatively only be responsible for the decision to select or continue to retain other investment managers.

ERISA Advisory Council

A group formed to advise the US Secretary of Labor on ERISA issues.

ERISA Duty of Care

The ERISA duty of care requires plan fiduciaries to "act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." This is commonly referred to as the "prudent expert" standard of US pension law (see Prudent Expert Rule).

ERISA Duty of Loyalty

The ERISA fiduciary duty of loyalty requires plan fiduciaries to act "solely in the interest of a plan's participants and beneficiaries." This generally requires the advisor to avoid conflicts of interest or manage them in the best interest of the client.

ERISA Exclusive Benefit Rule

This rule requires that a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan.

ERISA Section 404(c)(1)(A)

This section provides that, if the many requirements of Section 404(c)(1)(A) are satisfied, a plan permits a participant or beneficiary to exercise control over the assets in his account, and he or she exercises such control, the participant or beneficiary is not deemed to be a fiduciary, and no person who is otherwise a fiduciary is liable for any loss resulting from the participant or beneficiary's exercise of such control. (Note that the plan's fiduciaries remain responsible for selecting and maintaining the investment menu in accordance with their fiduciary duties, and for providing relevant information to participants through the extensive participant disclosure requirements.)

ERISA Section 405
This section provides that a fiduciary is liable for the breaches of another fiduciary if he or she knowingly participates or conceals the other's breach or enables another fiduciary to commit a breach by failing to carry out his/her own duties with the requisite care, skill, and prudence.

Fidelity Bond
An ERISA required form of business insurance that offers the Plan protection against losses that are caused by its employees' fraudulent or dishonest actions. This form of insurance can protect against monetary or physical losses.

Fiduciary
Under ERISA, any person who (1) exercises any discretionary authority or control over the management of a plan or the management or disposition of its assets, (2) renders investment advice for a fee or other compensation with respect to the funds or property of a plan or has the authority to do so, or (3) has any discretionary authority or responsibility in the administration of a plan.

Form 5500
The Form 5500 Series is part of ERISA's overall reporting and disclosure framework, which is intended to assure that employee benefit plans are operated and managed in accordance with certain prescribed standards and that participants and beneficiaries, as well as regulators, are provided or have access to sufficient information to protect the rights and benefits of participants and beneficiaries under employee benefit plans.

Hardship Withdrawal
An in-service withdrawal permitted under a Defined Contribution Plan because of the immediate and heavy financial need of a participant that cannot be satisfied from other resources. The conditions for a hardship withdrawal can be determined through either a safe harbor or a facts-and-circumstances test (in the case of a 401(k) plan), or as otherwise determined under the terms of the Plan document, in the case of a non-401(k) plan.

Investment Advisor or Manager
A professional who is responsible for providing investment advice and/or managing investment decisions. Investment advisors typically include wealth managers, financial advisors, trust officers, financial consultants, investment consultants, financial planners, and fiduciary advisors. The investment advisor can serve as a consultant without having discretionary authority to manage Plan assets; however, they often fall under 3(21) or 3(38) roles as so defined by ERISA.

Investment Advisers Act of 1940
A federal law that defines the role and responsibilities of certain investment advisors. The Act provides the legal framework for monitoring many of those who advise pension funds, individuals, and institutions on investing. It specifies what qualifies as investment advice and stipulates who must register with state and federal regulators in order to dispense it.

Pension Benefit Guaranty Corporation (PBGC)
Created by ERISA, the PBGC is intended to encourage the continuation and maintenance of private-sector defined benefit pension plans and provide timely and uninterrupted payment of pension benefits.

Pension Protection Act of 2006
A law that made wide-ranging changes to the retirement plan laws. The law was intended to help protect retirement accounts and hold companies that underfunded existing pension accounts accountable. The law also made several pension provisions from the Economic Growth and Tax Relief Reconciliation Act of 2001 permanent, including the increased individual retirement arrangement (IRA) contribution limits and increased salary deferral contribution limits to a 401(k). It also attempted to strengthen the overall pension system and reduce the reliance on the federal pension system and the Pension Benefit Guaranty Corporation.

Personally Identifiable Information (PII)
Information that, when used alone or with other relevant data, can identify an individual. PII may contain direct identifiers (e.g., passport information) that can identify a person uniquely or quasi-identifiers (e.g., race) that can be combined with other quasi-identifiers (e.g., date of birth) to successfully recognize an individual.

Plan Participant
An individual who is eligible to and in fact does participate in a retirement or welfare benefit plan in accordance with its term.

Plan Sponsor
A designated party—usually a company or employer—that established an employee welfare or retirement plan for the benefit of the organization's employees.

Plan Trustee
The entity, individual, or group of individuals who are designated to hold the assets of the trust for the benefit of plan participants and beneficiaries. Trustees are either designated in the plan document or appointed by another fiduciary, typically the employer that sponsors the plan.

Prudent Expert Rule
Rules contained in section 404(a)(1)(B) of ERISA that require the fiduciaries of an employee benefit plan to use the care, skill, prudence, and diligence then prevailing that someone familiar with such matters would use in the performance of their plan responsibilities.

Qualified Default Investment Alternative (QDIA)
A default fund for the assets of participants who have the right to choose their own plan investments but fail to do so. If the conditions of a DOL regulation under ERISA section 404(c)(5), including selection of an appropriate default investment vehicle and provision of adequate information to participants, are met, plan fiduciaries are relieved of many of their responsibilities for the investment results of participant accounts defaulted into the QDIA.

Qualified Domestic Relations Orders (QDRO)
A court order that entitles an alternate payee to receive some or all of a participant's benefits under a plan.

Qualified Retirement Plan
A plan whose provisions satisfy Internal Revenue Code section 401(a); sometimes used more broadly to include plans that qualify under other ERISA Code sections.

Securities Act of 1933
Created and passed into law to protect investors after the stock market crash of 1929. The legislation had two main goals: to ensure more transparency in financial statements so investors could make informed decisions about investments; and to establish laws against misrepresentation and fraudulent activities in the securities markets.

Summary Annual Report (SAR)
A report of overall plan financial information provided to each participant in a format published by the DOL. The information is derived from the Form 5500 series annual report.

Summary Plan Description (SPD)
A written description of the plan designed to provide a participant or beneficiary with a comprehensive but understandable overview of how the plan operates.

Tax Reform Act of 1986
A law that, among other things, modified the nondiscrimination rules and reduced the maximum annual 401(k) before-tax salary deferrals by employees previously in effect. It required all after-tax contributions to defined contribution plans to be included as annual additions under IRC Sec. 415 limits (which set the maximum annual addition that can be made to defined contribution plans).

Third-Party Administrator (TPA)
The TPA performs a variety of discrimination and compliance tests and prepares filings to regulatory agencies, the IRS, and the DOL. They may assist with plan design and influence eligibility and vesting, employer matching contributions, automatic enrollment, and other policies/options. They also provide plan document support.

Vesting
A legal term that means to give or earn a right to a present or future payment, asset, or benefit. It is most commonly used in reference to retirement plan benefits when an employee accrues nonforfeitable rights to the employee's qualified retirement plan account or pension plan benefits.

References: Benefits Law Group of Chicago; Employee Benefit Research Institute; *Prudent Practices for Investment Advisors* (Fi360); Pension Benefit Guaranty Corporation; 401(k) *Answer Book* (Wolters Kluwer, 2019); US Department of Labor.

Developed for Dimensional Fund Advisors by Ian S. Kopelman, partner at DLA Piper.

This guide was developed for Dimensional Fund Advisors LP ("Dimensional") principally by Ian S. Kopelman, a partner at DLA Piper LLP (US), and is intended solely to provide general guidance for plan sponsors and fiduciaries as well as investment and other retirement plan professionals. Information and opinions presented in this material have been obtained or derived from sources believed to be reliable; however, neither Dimensional Fund Advisors LP nor Mr. Kopelman represent that this information is accurate and complete, and it should not be relied upon as such.

Dimensional Fund Advisors LP and DLA Piper are separate, unaffiliated entities. Mr. Kopelman is an occasional speaker at events sponsored or hosted by Dimensional Fund Advisors LP.

Dimensional Fund Advisors LP is an investment advisor registered with the Securities and Exchange Commission.

The articles are distributed for informational purposes only and should not be considered investment, tax, or legal advice or an offer of any security for sale.

Dimensional does not endorse, recommend, or guarantee the services of any advisor, advisory, or consulting firm, nor any plan, person, or entity discussed herein.

Products may be mentioned or discussed that are not offered or sold by Dimensional Fund Advisors. Links to material hosted on another website are provided merely for convenience and do not imply any endorsement, representation, or warranty by Dimensional Fund Advisors with respect to any such linked website or the content, products, or services contained or accessible through such website or its operators. Linked sites are not under the control of Dimensional Fund Advisors, and Dimensional Fund Advisors is not responsible for the contents of any linked site or link contained in a linked site or any changes or updates to such site. Dimensional Fund Advisors disclaims responsibility for the privacy policies and customer information practices of any third-party website.

Investing involves risks. There is no guarantee investment strategies will be successful, and it is possible to lose money.

MKT-8783 12/20 1777948

AMERICAS
Austin, Charlotte, Santa Monica, Toronto, Vancouver

EUROPE
Amsterdam, Berlin, Dublin, London

ASIA PACIFIC
Hong Kong, Melbourne, Singapore, Sydney, Tokyo

dimensional.com