Volume XII | Number VIII | August 2014

Retirement Report

NEWS AND UPDATES FOR PLAN SPONSORS AND FIDUCIARIES OF DEFINED CONTRIBUTION PLANS

Time Flies – The Importance of Historical Scores

Historical scores are quickly forgotten when new scores are released, but are they really yesterday's news? In the same respect that rolling period returns are deemed important, rolling score history is equally if not more. Although the score was built to measure a long term time period (relative to our competitors), the most recent score may not always capture the different market environments it was meant to. For example, take the last five years, which have been anything but typical.

Time flies when you're having fun. It's hard to believe that it has been a full five years since we experienced what is still referred to as the "Great Recession." The Great Recession was the largest worldwide recession since World War II, beginning in late 2007 and ending in mid 2009. June of 2009 was the official date the U.S. National Bureau of Economic Research (NBER) marked as the end of the Great Recession. The U.S. capital markets, as they have a tendency to do, predicted the recovery before the NBER did, rebounding to a strong positive quarterly return in the second quarter of 2009. Five years ago marked the beginning of that rebound, or the bull market we are technically in today. The S&P 500 Index was up 15.9 percent that quarter, kicking off what would be a period of upward growth in both the equity and fixed income markets. Before the second quarter of 2009, the S&P 500 had posted six negative quarters of performance in a row.

Since the second quarter of 2009, capital markets have had a fairly smooth ride up. Over the past five year time period, the S&P 500 Index, representing U.S. equity markets, posted an annualized 21.2 percent return; the MSCI EAFE Index, representing international equity markets, posted an annualized 16.6 percent return; and the BC Aggregate Bond Index, representing fixed income markets, posted an annualized 4.8 percent return. These indices experienced only four quarters of negative performance over this five year time period. Certainly, it has been a period of economic improvement, but it has also been a period of unique and

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Fiduciary Liabilities:
What Are They? How Can They be Mitigated?

“Risk comes from not knowing what you are doing.”—Warren Buffett

Being an ERISA fiduciary may entail personal liability. In addition to making the plan whole for any losses resulting from a breach of fiduciary duty, a fiduciary may be required to disgorge any profits obtained in committing the breach, and be subject to “such other equitable or remedial relief” as a court may decide. Furthermore, the Department of Labor can impose on a fiduciary a penalty of 20% of any civil recovery.

Fiduciary duties under ERISA cannot be limited contractually, by participant waiver or otherwise (i.e., fiduciary exculpatory provisions are legally null and void). That is why many fiduciary committee members focus on the following important points:

• Prudence Means Knowing What to Know
“Common sense is not so common.”—Voltaire

In general, ERISA focuses more on a prudent process, rather than a prudent result. Being fully aware of your responsibilities (certainly in greater detail than set forth in this short summary) will help you best discharge your responsibilities prudently. This includes understanding the plan documents and their general operations. Established practice at many companies is to provide fiduciary “training” for new members, as well as refreshers at least annually. You should consider taking advantage of these and other available resources, as they will help familiarize you with the standards and obligations applicable to you. In addition, many fiduciaries also find a periodic compliance “audit” of plan documents, administrative processes and other matters helpful. Of course, you must act prudently in all of your plan-related activities.

• Prudence Means Knowing What You Don’t Know
“The only real knowledge comes when you recognize what you don’t know.”—Socrates (adapted)

As discussed below, sometimes the prudent thing is to conclude that you aren’t an expert on a given subject or responsibility. In other words, the prudent thing may be to seek help. As the Department of Labor notes “[t] he duty to act prudently is one of a fiduciary’s central responsibilities under ERISA. It requires expertise in a variety of areas, such as investments. Lacking that expertise, a fiduciary will want to hire someone with that professional knowledge to carry out the investment and other functions especially given the standards to which fiduciaries are held under ERISA.”

• Prudence Means Knowing When to Delegate
“Who is wise? He who learns from all people.” Babylonian Talmud, Avot.

ERISA provides that to the extent a named fiduciary delegates investment management authority to any third-party service provider, “then such named fiduciary shall not be liable for an act or omission of such [hired third party] in carrying out such responsibility,” except to the extent that the delegation itself is imprudent. This applies to a variety of service providers, such as investment managers, custodians, recordkeepers, third-party administrators and others. Some functions may most properly remain “in house.” For other functions, the committee will most certainly wish to delegate.

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Every Fund Has Style!

The Investment Due Diligence process places an important emphasis on a fund's style, employing a technique called "quadratic optimization." A big word, and even bigger mathematical equation, which calculates the style of a fund, reflecting how a fund behaves, or what segment of the market the fund best represents. Most managers have a unique investment philosophy that decidedly places them in some segment of the equity or fixed income marketplace. The U.S. equity marketplace has some of the most numerous and varied managers, whose focus ranges from large company stocks to small company stocks, and whose stock prices may be considered to be "value" (companies with low prices relative to various accounting measures) or "growth" (fast growing companies with high growth rates). Many managers may also reflect what is called a "blend" style, which means they invest in both "value" and "growth" companies.

Style is important for two reasons. First, it helps determine whether a plan is well diversified among its various investments. At the most basic level, it is important to have investment exposure in a broad array of asset classes, from U.S. equity and international equity to fixed income. Understanding a fund's style within these asset classes allows the investor to be well diversified, or said another way, not have "all eggs in one basket." For some asset classes, such as U.S. equity, there is often a greater level of analysis that needs to be done to determine the diversification among the different styles. Secondly, style helps determine manager skill. Without style analysis, we would not be able to tell with any certainty if a certain benchmark is correct for a fund, or if that fund is being classified in its most appropriate area. A well performing small cap fund may look attractive against the S&P 500 Index (a large cap benchmark), but analyzing it more closely against an appropriate small cap benchmark may lead to the conclusion that the manager has done a poor job selecting small cap stocks (due to the fund's "relative" performance). Indeed, measuring a fund against its most appropriate benchmark helps find the most skilled managers in their respective categories.

Are You Monitoring Your Forfeiture Account

Qualified plans have a requirement to not carry forward any unallocated assets from year to year. Unfortunately, this rule is frequently neglected by plan sponsors, much to their chagrin when the failure is discovered on audit by the Internal Revenue Service (IRS) or Department of Labor (DOL). Thus, it is important to remember that forfeitures must be allocated on an annual basis. The process is typically determined per the provisions in your plan document, or by plan procedures. Forfeitures should not be held over from year to year; if they remain accidentally unallocated, complications can result. On audit it is not uncommon for the regulatory agencies to require a plan sponsor to retroactively determine who should have received allocations on a year by year basis. Once those retroactive allocations have been made, the regulatory agencies typically require the plan sponsor come out of corporate pocket for earnings on all retroactively allocated amounts. This is not only a monetary burden, but an administrative burden as well due to the fact that fiduciaries must find participants who may have terminated, because they were due these allocations (and earnings) as well as participants who remain active. For questions on this topic, contact your plan consultant.

Time Flies

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unprecedented easy monetary policy. Over the past five years, not only has the Federal Reserve (the Fed) kept short term rates low with the Fed Funds' rate in the 0-.25 percent range, but the Fed has also kept long term rates low through its quantitative easing policy. However, this is something that will likely change over the next five years as the Fed has already started to reduce the bonds it buys through its quantitative easing policy.

With any type of performance evaluation, it is important to recognize the period in which performance is being evaluated. The last five years was certainly unique in its easy money, slow growth type of environment. When simply looking at this time period, it is important to give careful review of the analytics behind the score, as scores of the first quarter of 2014 now reflect this five year time period. Times like these stress the importance of looking at a fund's historical scores, which will most often incorporate different types of markets. Even five year time periods may not be sufficiently long enough when trying to measure skill within different types of market environments. For this reason, we recommend always reviewing and looking at the past eight quarters worth of scores in addition to the most recent score. Historical scores can be found in the "Score History" portion of the Fiduciary Investment Review or within the Fund Fact Sheet. Score history serves as a good reminder as to why a fund was chosen in the first place, or why a certain manager/strategy continues to be valuable today amid an environment that is anything but five years ago.

Fiduciary Liabilities

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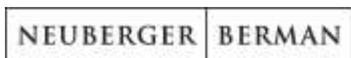
For example, if a named fiduciary or fiduciary investment committee prudently hires an investment manager to manage all or a part of the assets of a plan in a separate account, the named fiduciary or investment committee would generally not be liable for the portfolio-level transactions effected by the investment manager in the account; although it would still need to be prudent in monitoring the manager's performance. By contrast, were no such delegation in place, or if the delegation were made to one or more persons that do not meet the ERISA definition of an investment manager, the named fiduciary or investment committee could be personally liable for each and every plan investment under its care, as well as for the imprudent decision not to retain a statutory investment manager or leverage other service providers.

• Fiduciary Insurance

Many fiduciaries are covered by their employer's insurance policy against certain claims of fiduciary breaches. It may be appropriate for you to check your company's coverage as to whether it covers your activities as a member of the plan's investment committee and the amount of coverage it affords. (Separately, you may also wish to confirm that your employer will make sure that you will be appropriately "bonded" under ERISA—a separate requirement.)



This article is an excerpt from Neuberger Berman's White Paper: *Top Ten Questions that New 401(k) Committee Members Shouldn't be Afraid to Ask.*

COMMUNICATION CORNER: Helping Solve Your Retirement Income Puzzle

This month's employee memo is titled, "Target Date Funds: Helping Solve Your Retirement Income Puzzle." The memo gives participants the opportunity to put their target date fund knowledge to the test in our fun crossword puzzle.

As a reminder, we post each monthly participant memo online via the Fiduciary Briefcase™ (fiduciarybriefcase.com) and it is also available in Spanish.

Call or email your Plan Consultant if you have questions or need assistance.

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