Managing the Due Diligence Process
2014 Colorado Public Plan Coalition Annual Conference

Presented by:
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RICK RODGERS, AIFA®

• Vice President, Director and Consultant at Innovest Portfolio Solutions

• More than 27 years experience developing, designing and delivering retirement plan and investment education and advice

• fi360 Fiduciary Governance Designee
  – Accredited Investment Fiduciary (AIF®)
  – Accredited Investment Fiduciary Analyst (AIFA®)
  – Certified CEFEX Analyst

• 25 national awards for retirement plan design, participant education and investment education

• Before this? Professional musician.
SESSION OVERVIEW

- Understanding Fiduciary Responsibilities
- The Due Diligence Process
- Regulatory References
UNDERSTANDING FIDUCIARY RESPONSIBILITIES
WHO IS A RETIREMENT PLAN FIDUCIARY?

• Anyone who has responsibility for other people’s money
• Many actions involved in operating a plan make the person or entity a fiduciary
  - Using discretion in administering and managing a plan or controlling the plan’s assets makes that person a fiduciary (to the extent of that discretion or control)
  - Hire, fire or retain service providers
  - Appoints Trustees
  - Serves as a member of the Trustee Committee
  - Provides investment advice to the plan or its participants for a fee
• Fiduciary status based upon functions performed, not just a person’s title

Source: ERISA § 3(21); Black’s Law Dictionary 17th Edition.
RETIREMENT PLAN FIDUCIARIES

• Plans must have at least one fiduciary (person or entity) named in the written Plan, or through a process described in the Plan as having control over the Plan’s operation

• Named fiduciary can be identified by office or name

• May be an administrative Committee or Board

• Fiduciaries
  - Trustee(s)
  - Investment advisers
  - All individuals exercising discretion in administration of the plan

• NOT Fiduciaries
  - Attorneys, accountants, and actuaries – when acting solely in their professional capacities

• The key to determining whether an individual or entity is a fiduciary is to determine if they are exercising discretion or control over the Plan assets
FIDUCIARY DUTY

• Trustees and plan administrators have a fiduciary duty to the plan participants
• Requires the Highest Standard of Care
• Fiduciary duties under ERISA are the highest known to law
• In recent years it has become higher and broader as plans utilize new and different investment options, and advice
FIDUCIARY DUTY

• Fiduciary duty encompasses two important legal concepts:
  - The duty of loyalty
  - The duty of prudence
DUTY OF LOYALTY

• Act solely in the interest of plan participants and beneficiaries (duty of loyalty).

• The duty of loyalty forbids a fiduciary not only from using plan assets for his or her personal interest but also from favoring the best interests of a third party over the interests of a plan participant, even if the fiduciary’s own interests are not impacted.

First the lawsuit, and now this. I wish I’d known about the “fiduciary duty of loyalty and good faith in disclosures” before I lied my @$ off.
DUTY OF PRUDENCE

• To be careful, diligent, thorough, and scrupulous in all decision-making, including the way you delegate duties to others.
PRUDENT PROCESS ALWAYS INVOLVES TWO PARTS

- Procedural Prudence:
  - Consider what information is relevant to the decision
  - Obtain the information
  - Analyze the information

- Substantive Prudence:
  - Make a reasoned decision that other experts in similar situations would make
  - Verify implementation of the required action
  - Document the decision
DELEGATION

• Delegation is permitted and even encouraged by the law\(^1\)
• It is well recognized that trustees cannot personally perform every necessary function
• Nor can they be expected to possess all of the required expertise
• Trustees do, however, have the **ultimate** fiduciary responsibility
• They can delegate, but they cannot **abdicate**

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CAREFUL DELEGATION

- **Selecting** the persons or agents to perform the functions
- **Monitoring** the work being performed by the agents
- **Evaluating** the quality and timeliness of the work
- **Making** appropriate changes if warranted
PROCESS, NOT HINDSIGHT, IS THE RELEVANT STANDARD

Compliance with the prudent investor rule is determined in light of the facts and circumstances existing at the time of the trustee’s decision or action and not by hindsight.

Uniform Prudent Investor Act (UPIA)
# REAL LIFE EXAMPLES

<table>
<thead>
<tr>
<th>The Problem</th>
<th>Fiduciary Concern</th>
<th>Penalty Paid by Employer</th>
</tr>
</thead>
<tbody>
<tr>
<td>CPA firm hired by Plan failed to complete 5500 Audit 2 years in a row.</td>
<td>Trustee Responsibility and Liability <strong>Plan Management</strong></td>
<td>$100,000 fine negotiated down to $10,000</td>
</tr>
<tr>
<td><strong>Broker</strong> recommended replacing an investment option with one that turned out to be less profitable.</td>
<td>Trustee Responsibility and Liability <strong>Investment Decisions</strong></td>
<td>$500,000 in damages plus $358,000 in defense costs</td>
</tr>
<tr>
<td><strong>Two employees</strong> approaching retirement discovered they never enrolled in the company’s 401(k) Plan.</td>
<td>Trustee Responsibility and Liability <strong>Employee Communications</strong></td>
<td>$378,000 settlement plus over $200,000 in defense costs</td>
</tr>
<tr>
<td><strong>Recordkeeper and third party administrator</strong> improperly delayed executing participant buy-sell orders and transferring fund balances.</td>
<td>Trustee Responsibility and Liability <strong>Service Provider Selection, Oversight, and Due Diligence</strong></td>
<td>$1,000,000 in damages for lost investment earnings plus $250,000 in defense costs</td>
</tr>
<tr>
<td><strong>Small 401(k) Plan</strong> lost $775,000 in an investment fraud perpetrated by their financial representative.</td>
<td>Trustee Responsibility and Liability <strong>Service Provider Selection, Oversight, and Due Diligence</strong></td>
<td>$775,000 plus lost interest and opportunity costs. (DOL lawsuit underway)</td>
</tr>
</tbody>
</table>
WHAT HAVE PROVIDERS SAID IN COURT?

• Most often when Plans are sued, the mutual fund company or insurance company has claimed not to be a fiduciary

• They immediately placed all blame solely on the Plan Sponsor and their retirement committee

• Hecker v. Deere, Fidelity Research, Fidelity Trust (1990)
  - Fidelity Trust advised Deere on investments included in the Plan
  - Included 23 Fidelity mutual funds, 2 other investments managed by Fidelity Trust and Deere stock
  - Hecker alleged Fidelity Research shared fees with Fidelity Trust and that fees charged for investment management were allocated to Plan administration
  - Hecker alleged fees were unreasonable and excessive, and undisclosed
  - Hecker alleged fund selection was not objective
  - Fidelity Trust and Fidelity Research not held liable; Deere had the sole responsibility for investment selection
PROVIDERS SUE PLAN SPONSORS?

- Large life insurance and financial services company filed a countersuit alleging the “Trustees are reckless and also at fault to the extent the Plans suffered any harm..., because the Trustees had the ultimate responsibility for managing the Plan, and investing Plan assets”\(^1\)

- Another large insurance company countersued their client Charters (the Plan trustee) for breach of fiduciary duty, monetary contribution and indemnity for being negligent in hiring them in the first place.\(^2\)

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THE DUE DILIGENCE PROCESS
SEVEN FIDUCIARY PRECEPTS

1. Know standards, laws and trust provisions.
2. Diversify assets to specific risk/return profile of plan.
4. Use prudent experts and document due diligence.
5. Control and account for investment and plan expenses.
6. Monitor the activities of “prudent experts.”
7. Avoid conflicts of interest and prohibited transactions.
FOLLOW A PRUDENT PROCESS

- Analyze
- Strategize
- Formalize
- Implement
- Monitor
  - Providers
  - Products Offered
  - Related Expenses
STEP 1: **ANALYZE**

- The investment management process begins with a thorough understanding of your current situation and future needs.

- To implement the process it is necessary to obtain a complete understanding of your current financial position, legal and regulatory constraints, current service providers and professional advisors, and investment risk/return profile.
Collect, review, and analyze investment files:

- Investment policy statements (IPS);
- Applicable trust documents (including amendments);
- Custodial and brokerage statements so that current fees and expenses for investment management can be analyzed;
- Service agreements with investment management vendors (custodians, money managers, investment consultant, actuary, accountant, or attorney);
- Information on retained money managers, such as a prospectus or similar documents; and
- Any other files pertaining to the management of your portfolio.
CONSIDERATIONS FOR TRUSTEE EDUCATION

POLICY

• Written acknowledgement of required reading
  - Plan document/trust agreement
  - Summary Plan Description (SPD)
  - Investment Policy Statement (IPS)
  - Regulatory references (IRC, State Statute, UPIA, ERISA)

• Continuing education, minimum hourly requirement (annual or bi-annual)
  - Trustee education workshops
  - Industry conferences
  - Webinars
DEFINED CONTRIBUTION PLAN CORE COMPONENTS

Recordkeeping/ Administration
- Daily Operations
- Plan Management
- Customer Service
- Contributions
- Transactions
- Statements
- Reporting
- Web Transactions
- VRU

Trust and Custody
- Custodian
- Trustee
- Trading Platform

Participant Education
- Collateral Material
- Web-based Info
- Newsletters
- Ed Workshops
- Individual Counseling

Investment Services
- Investment Selection and Monitoring
- Managers
  - Mutual Funds
  - Separate Accts.
- Overall Plan Consulting
- Fiduciary Compliance

Legal and Compliance
- Plan Document
- QDROs
- Legal Defense
- Regulatory Compliance
STEP 2: STRATEGIZE
Identify Assets and Build the Portfolio/Menu

The next dimension is: “Identify Assets and Build the Investment Menu.”

As a fiduciary, your role is to decide which assets (the talents of staff members and hired money managers) and assets classes, optimally allocated, will produce the greatest probability of achieving your stated objectives.

The asset allocation process begins with a thoughtful discussion focusing on the relative attractiveness of the broad asset classes and ensuring that you have a good understanding of the risk/return of each. Consideration should be given to diversifying the menu into a broadly diversified mix.
THE IMPORTANCE OF ASSET ALLOCATION

Asset Allocation Policy: 91%
Security Selection: 5%
Other Factors: 2%
Market Timing: 2%

STEP 3: FORMALIZE
MAINTAIN AN INVESTMENT POLICY STATEMENT

• In the case of you serving in a fiduciary capacity, the IPS is the essential document that auditors, regulators, and the courts will review to help determine whether the plan is being prudently managed.

• The IPS provides a paper trail of practices, and procedures for decisions. The document can serve as critical evidence used in the defenses against litigation or accusations of imprudence.

• Perhaps most important function performed by retirement plan fiduciaries

• Provides working framework for trustees and advisors for evaluating investment performance

• Eliminates emotion-based decision making

• Establishes investment options and guidelines for making investment decisions
  - Provides replacement criteria

• Maintains consistency when Board Members are replaced
STEP 4: IMPLEMENT

- ANALYZE
- STRATEGIZE
- IMPLEMENT
- FORMALIZE
- MONITOR
Define the Process for Selecting Key Personnel to Implement the Strategy

Develop uniform search criteria that:

- Can be applied to every asset class;
- Can be applied to all structures of investments;
- That can be easily communicated; and
- Can be used in both the search and monitoring phases of the decision-making process.
MANAGER SELECTION

- Completely open universe with no proprietary funds
- Proper benchmarking is key to performance evaluation
- Consistent managers perform better in the long run
- Risk management is integral at every step and on every level
- A complete understanding of the “whys” of performance is crucial
- There is a direct trade-off between performance and fees and expenses
**MANAGER SELECTION PROCESS: DUE DILIGENCE**

Our forward-looking due diligence process strives to separate luck from skill in manager performance.

<table>
<thead>
<tr>
<th>Manager Identification</th>
<th>Quantitative and fundamental screening (databases)</th>
<th>Multiple manager databases</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Direct solicitation by managers</td>
<td>Trade journals</td>
</tr>
<tr>
<td></td>
<td>Referrals from industry contacts</td>
<td>Referrals from investors</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Quantitative Analysis</th>
<th>Performance analysis</th>
<th>Market exposures/risks</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Performance attribution</td>
<td>responsible for driving</td>
</tr>
<tr>
<td></td>
<td>Consistency analysis</td>
<td>returns</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Risk-adjusted value added vs.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>benchmarks and peers</td>
</tr>
</tbody>
</table>

| Qualitative Analysis    | Organizational and personnel evaluation             | Philosophy and process       |
|-------------------------|-----------------------------------------------------| uniqueness and sustainability|
|                         | Experience and stability                             | Conflicts, compensation, and |
|                         |                                                      | board structure               |

| Manager Assessment      | Why should we hire?                                  | Intellectual, strategy,      |
|-------------------------|-------------------------------------------------------| resource, implementation     |
|                         | What edge does the manager have over its peers?      | Pros and cons                |
The key entity that needs to be prudently selected at this point is the recordkeeper/custodian for your plan; a key provider which will greatly impact the quality of your plan.

The role of the recordkeeper/custodian is to:

- Provide an interface for employees to transact on their accounts;
- Handle all transactions initiated by the participants;
- Value the accounts, provide statements and online access to these values;
- Provide monthly reports that detail transactions, cash flows, securities held and their current value, and change in values;
- Provide a menu of investment options.
In conducting due diligence on the custodian/recordkeeper, consider the following:

- Quality of service provider to employees
- Quality of service provided to committee and employer as the plan sponsor
- Participant education of high quality and sufficient to meet participants needs?
- Is the investment universe broad and flexible? Are there proprietary product requirements?
- A cost analysis based on total cost to participants as well as the total revenue received by the custodian/recordkeeper.
CREATE A DUE DILIGENCE REPORT (DDR)

- Written documentation of entire process
- Copy of RFP, RFI questionnaire or Benchmarking specs
- Correspondence with respondents
- Copy of responses
- Excerpts from meeting minutes
- Documentation of finalists presentations
- Third-party benchmarking reports
- Copy of agreement
- Included as part of Permanent Fiduciary File
STEP 5: MONITOR

ANALYZE

MONITOR

STRATEGIZE

IMPLEMENT

FORMALIZE

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STEP 5: MONITOR

FUND INFORMATION

PEER GROUP ANALYSIS - IM U.S. Broad Market Core Fixed Income (MF)

RISK VS. RETURN (5 YEARS)*

CALENDAR YEAR RETURNS AND PERCENTILE RANKINGS

ROLLING 3 YEAR RETURN AND PERCENTILE RANKINGS

*If less than 5 years, data is since inception of fund share class.
STEP 5: MONITOR

PIMCO Tot Rtn Admn 03/31/13

PORTFOLIO CHARACTERISTICS
- Avg. Coupon: 3.55 Years
- Nominal Maturity: 6.09 Years
- Effective Maturity: N/A
- Duration: 4.77 Years
- SEC 30 Day Yield: 2.19
- Avg. Credit Quality: N/A

TOP SECTOR ALLOCATIONS
- GNMA and Other Mtg Backed: 45.00%
- Corporate Notes/Bonds: 23.00%
- Fgn. Currency Denominated Bonds: 13.00%
- Government Agency Securities: 12.00%
- Treasury Notes/Bonds: 10.00%

ASSET ALLOCATION
- Fixed Income: 100.0%
- Other: 0.0%
- Equities: 0.0%
- Convertibles: 0.0%
- Cash: 0.0%

MATURITY DISTRIBUTION
- 1-3Yrs: 42.4%
- 3-5Yrs: 28.2%
- 5-10Yrs: 16.0%
- Other: 5.0%
- 20-30Yrs: 3.9%
- <1Yr: 0.0%
- >30Yrs: 0.0%

QUALITY ALLOCATION
- Government/AAA: 44.3%
- Foreign Securities: 13.0%
- BBB Rated: 10.9%
- AA Rated: 18.5%
- BB AND B Rated: 0.4%
- Equities/Other: 0.0%
- CCC, CC AND C rated: 0.0%

STYLE MAP (10/01/94 - 03/31/13)

UP/DOWN CAPTURE (04/01/06 - 03/31/13)

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Perform periodic qualitative or performance reviews of decision-makers

### Manager Score Card

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Organization</th>
<th>People</th>
<th>Philosophy &amp; Process</th>
<th>Style Consistency</th>
<th>Asset Base</th>
<th>Performance</th>
<th>Expenses</th>
<th>Overall</th>
<th>Exp Ratio (%)</th>
<th>Median Exp Ratio (%)</th>
<th>Ratio of Exp to Median (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vantagepoint 500Sk (VPSKX)</td>
<td>Green</td>
<td>Green</td>
<td>Green</td>
<td>Green</td>
<td>Green</td>
<td>Green</td>
<td>Green</td>
<td>Green</td>
<td>0.23</td>
<td>0.63</td>
<td>36.40</td>
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<tr>
<td>Davis NY Venture Y (DNVYYX)</td>
<td>Green</td>
<td>Green</td>
<td>Green</td>
<td>Green</td>
<td>Green</td>
<td>Red</td>
<td>Green</td>
<td>Green</td>
<td>0.62</td>
<td>1.25</td>
<td>49.60</td>
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<tr>
<td>T Rowe Price BC Gro/Adv (PABGX)</td>
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<td>Green</td>
<td>Green</td>
<td>Green</td>
<td>Red</td>
<td>Green</td>
<td>Green</td>
<td>1.00</td>
<td>1.33</td>
<td>75.17</td>
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<td>Holchik's Mid Cap Vsl (HWMIX)</td>
<td>Green</td>
<td>Green</td>
<td>Red</td>
<td>Red</td>
<td>Green</td>
<td>Red</td>
<td>Green</td>
<td>Green</td>
<td>1.10</td>
<td>1.35</td>
<td>79.55</td>
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<td>Turner Midcap Gro/Inv (TMGFX)</td>
<td>Green</td>
<td>Green</td>
<td>Green</td>
<td>Green</td>
<td>Green</td>
<td>Red</td>
<td>Green</td>
<td>Green</td>
<td>1.18</td>
<td>1.41</td>
<td>63.09</td>
</tr>
<tr>
<td>Perkins SC Value I (JSCOX)</td>
<td>Green</td>
<td>Green</td>
<td>Green</td>
<td>Green</td>
<td>Green</td>
<td>Red</td>
<td>Green</td>
<td>Green</td>
<td>0.85</td>
<td>1.53</td>
<td>65.56</td>
</tr>
<tr>
<td>Invesco Sm Cap Gr R5 (GTSMX)</td>
<td>Red</td>
<td>Red</td>
<td>Red</td>
<td>Green</td>
<td>Green</td>
<td>Red</td>
<td>Green</td>
<td>Green</td>
<td>0.82</td>
<td>1.55</td>
<td>52.50</td>
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<tr>
<td>Harbor Intl/Adm (HRNIX)</td>
<td>Green</td>
<td>Green</td>
<td>Green</td>
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<td>Green</td>
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<td>1.04</td>
<td>1.30</td>
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<td>American Funds EuPc-R-I (REVX)</td>
<td>Green</td>
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<td>0.85</td>
<td>1.40</td>
<td>58.22</td>
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<tr>
<td>PIMCO Total Return (PTRA)</td>
<td>Green</td>
<td>Green</td>
<td>Green</td>
<td>Green</td>
<td>Green</td>
<td>Red</td>
<td>Green</td>
<td>Green</td>
<td>0.72</td>
<td>0.92</td>
<td>78.25</td>
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<tr>
<td>Vanguard Sh/Im Inv/Adm (VIFSX)</td>
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<td>Green</td>
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<td>0.11</td>
<td>0.82</td>
<td>13.58</td>
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<td>Calendario/Weiser RS (GSRX)</td>
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<td>Green</td>
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<td>Red</td>
<td>Green</td>
<td>Green</td>
<td>0.70</td>
<td>1.41</td>
<td>53.19</td>
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<td>Vantage Trust Plus</td>
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<td>Green</td>
<td>Red</td>
<td>Green</td>
<td>Green</td>
<td>0.56</td>
<td>0.50</td>
<td>112.00</td>
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<tr>
<td>Vantagepoint Cs Gr M (VPGDX)</td>
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<td>Green</td>
<td>Green</td>
<td>Red</td>
<td>Green</td>
<td>Green</td>
<td>0.85</td>
<td>1.32</td>
<td>64.39</td>
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<tr>
<td>Vantagepoint Trail Gr M (VFTGDX)</td>
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<td>Green</td>
<td>Green</td>
<td>Green</td>
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<td>Red</td>
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<td>0.88</td>
<td>1.42</td>
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<td>Vantagepoint L-T Gr M (VPLGDX)</td>
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<td>Green</td>
<td>Green</td>
<td>Green</td>
<td>Red</td>
<td>Green</td>
<td>Green</td>
<td>0.92</td>
<td>1.40</td>
<td>66.10</td>
</tr>
<tr>
<td>Vantagepoint All-Eq/M (VPAGX)</td>
<td>Green</td>
<td>Green</td>
<td>Green</td>
<td>Green</td>
<td>Green</td>
<td>Red</td>
<td>Green</td>
<td>Green</td>
<td>0.99</td>
<td>1.40</td>
<td>71.22</td>
</tr>
</tbody>
</table>

### Comments

**Manager**

**Davis NY Venture Y (DNVYYX)**

**Score Factor:** Performance

Stock selection has been poor as the fund was overweight financials 2007-2009 and, more recently, has held larger positions in ideas that did not pan out. Further, although their picks require sign-off from Chris Davis, 20% of the portfolio is managed by two analysts, Stephen Chen and Carlton Gooi. Two particularly troubling picks came from this part of the portfolio, Groupon and Sino Forest, a Canadian domiciled Chinese timber company. At the time of their purchase it was our estimation that neither of these securities held the Davis requirement of “strong management” or could be considered value propositions. Although they were only a small part of the portfolio, the divergence warrants mentioning. This poor stock selection has led to equally poor performance. Over the annual periods from 2008 to 2012 the fund has finished in the top half of its peer group only one time and the fund continues to struggle to recover from its missteps and return to form.

**Tumer Midcap Gro/Inv (TMGFX)**

**Score Factor:** Performance

From 2008 to 2012, the fund has finished in the bottom quartile of its mid cap growth peer group in three of the annual periods. The boom-or-bust style has resulted in inconsistent returns with large losses and the strategy’s more recent hits have done very little to make up for significant lost ground.

**Perkins SC Value I (JSCOX)**

**Score Factor:** People

Lead PM Todd Perkins left the firm for personal and family reasons effective March 31, 2013. Although founder Bob Perkins and other PM Justin Tugman remain on the strategy, Todd was responsible for many of the day-to-day decisions and was seen as the successor for Bob once he retires.
## DUE DILIGENCE PROCESS

<table>
<thead>
<tr>
<th>Occurrence</th>
<th>Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>Daily</td>
<td>We review trades and reconcile accounts. Manager due diligence meetings are held both on and off-site.</td>
</tr>
<tr>
<td>Weekly</td>
<td>Innovest’s Investment Committee meets to review managers, client portfolios, and the financial markets. Special attention is reserved for managers with qualitative issues.</td>
</tr>
<tr>
<td>Monthly</td>
<td>We conduct quantitative analysis to identify outlier managers, both positive and negative, for comprehensive evaluation.</td>
</tr>
<tr>
<td>Quarterly</td>
<td>Manager calls are made and portfolio attribution is conducted to help determine “why” performance happened. Custom reports are developed for each client. Client meetings are conducted to review portfolio performance, managers, and policy.</td>
</tr>
<tr>
<td>Annually</td>
<td>We review the Due Diligence Questionnaire for every manager. Due diligence meetings are conducted and manager review documentation is created. Capital market assumptions are determined after thoughtful analysis.</td>
</tr>
</tbody>
</table>
Persons responsible for managing retirement plans (a.k.a. fiduciaries) must ensure:

- Plan services are necessary
- Costs for services are reasonable

If a plan sponsor does not understand plan components, their associated costs and how they work, fiduciary responsibilities may not be fulfilled.
Cost Components: Where are the fees in your plan?

Defined Contribution Plan Costs

<table>
<thead>
<tr>
<th>Investment Management Fees</th>
<th>Plan Administration and Recordkeeping Expenses</th>
<th>Investment Consulting/Plan Advice Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mutual Funds</td>
<td>Processing, Recordkeeping</td>
<td>Performance Monitoring</td>
</tr>
<tr>
<td>Collective Trust Funds</td>
<td>Participant Education</td>
<td>Due Diligence, Hiring, Retaining and</td>
</tr>
<tr>
<td>Annuities</td>
<td>Trustee/Custodial Services</td>
<td>Monitoring of Funds and Investment</td>
</tr>
<tr>
<td>Separately Managed Accounts</td>
<td>Compliance Testing</td>
<td>Managers</td>
</tr>
<tr>
<td></td>
<td>Plan Documents and Amendments</td>
<td>Investment Policy</td>
</tr>
<tr>
<td></td>
<td>Distribution/Contribution Administration</td>
<td>Statement Preparation</td>
</tr>
</tbody>
</table>
Revenue sharing: A portion of investment fees are used to subsidize the cost of plan administration

<table>
<thead>
<tr>
<th>Annual Operating Expenses</th>
<th>As % of Assets (Annual Operating Expense Ratio)</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management Fee</td>
<td>0.80%</td>
<td>0.80% retained by Small Cap ABC manager</td>
</tr>
<tr>
<td>Distribution Fees</td>
<td>0.25%</td>
<td>0.25% paid to recordkeeper (shareholder servicing)</td>
</tr>
<tr>
<td>Sub T/A</td>
<td>0.10%</td>
<td>0.10%(recordkeeping fee)</td>
</tr>
<tr>
<td><strong>Total Operating Expenses</strong></td>
<td><strong>1.15%</strong></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Management Fee (0.80%)</th>
<th>Distribution (12b-1) Fee (0.25%)</th>
<th>Sub T/A</th>
</tr>
</thead>
<tbody>
<tr>
<td>$10,000 @ 0.80% = $80</td>
<td>$10,000 @ 0.25% = $25</td>
<td>$10,000 @ 0.10% = $10</td>
</tr>
<tr>
<td>Retained by Small Cap ABC Fund for investment manager</td>
<td>Paid to recordkeeper</td>
<td>Paid to recordkeeper</td>
</tr>
<tr>
<td>$80</td>
<td>$25</td>
<td>$10</td>
</tr>
</tbody>
</table>

For illustrative purposes only. Not indicative of any specific fund.
Revenue differences from different share classes

Example: Small Cap ABC Fund

<table>
<thead>
<tr>
<th>Share Class</th>
<th>Portfolio Management Fee</th>
<th>Distribution (12b-1) Fee</th>
<th>Sub T/A Admin/Opns</th>
<th>Total Expense Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>0.80%</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.80%</td>
</tr>
<tr>
<td>A</td>
<td>0.80%</td>
<td>0.25%</td>
<td>0.10%</td>
<td>1.15%</td>
</tr>
</tbody>
</table>

*For illustrative purposes only. Not indicative of any specific fund.*
Perform periodic examinations of costs

### Annual Fee Review

**Sample Client**
- Plan assets as of 12/31/2013: $30,510,195
- Estimated Investment, Recordkeeping and Administrative Costs: 0.66%
- Estimated Total Plan Expenses: 0.66%

#### Total Plan Expenses

<table>
<thead>
<tr>
<th>Description</th>
<th>Weighted average (bps)</th>
<th>Employer Paid</th>
<th>Employee Paid</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset based fee retained by funds</td>
<td>47</td>
<td>$</td>
<td>$143,639</td>
<td>$143,639</td>
</tr>
<tr>
<td>Revenue sharing paid to plan provider</td>
<td>6</td>
<td>$</td>
<td>$19,634</td>
<td>$19,634</td>
</tr>
<tr>
<td>Per participant fee</td>
<td>0</td>
<td>$</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>Administration/Recordkeeping fee</td>
<td>0</td>
<td>$</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>Custodial/Trust fees</td>
<td>0</td>
<td>$</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>Direct participant paid fees</td>
<td></td>
<td>$</td>
<td>$1,575</td>
<td>$1,575</td>
</tr>
<tr>
<td>Loan origination</td>
<td>1</td>
<td>$</td>
<td>$1,575</td>
<td>$1,575</td>
</tr>
<tr>
<td>Loan maintenance</td>
<td>0</td>
<td>$</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>QDRO</td>
<td>0</td>
<td>$</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>0</td>
<td>$</td>
<td>$122</td>
<td>$122</td>
</tr>
<tr>
<td>Rebate/Shortfall to plan</td>
<td>2</td>
<td>$</td>
<td>$5,790</td>
<td>$5,790</td>
</tr>
<tr>
<td>Total Investment, Recordkeeping and Administrative Costs</td>
<td>56</td>
<td>$</td>
<td>$170,660</td>
<td>$170,660</td>
</tr>
<tr>
<td>Third party plan paid fees</td>
<td></td>
<td>$31,500</td>
<td>$</td>
<td>$31,500</td>
</tr>
<tr>
<td>Investment Consultant</td>
<td>10</td>
<td>$31,500</td>
<td>$</td>
<td>$31,500</td>
</tr>
<tr>
<td>Total Plan Expenses</td>
<td>68</td>
<td>$31,500</td>
<td>$170,660</td>
<td>$202,160</td>
</tr>
</tbody>
</table>

Fee review reflects activity for the following time period: 10/1/2013 - 12/31/2013

**Benchmarking:**
The plan's estimated investment, recordkeeping and administrative costs of 0.66% as shown above, compare favorably to 401(k) Source data, a universe of 91 similarly sized 401(k) plans with an average investment, recordkeeping and administrative cost of 1.27%.
Perform periodic examinations of costs

<table>
<thead>
<tr>
<th>Sample Client Alternative Share Class Study</th>
<th>prepared by Doug Ingles</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Funds In Plan Available on Milliman</td>
<td>Ticker Symbol</td>
</tr>
<tr>
<td>Harbor Capital Appreciation</td>
<td>HACAX</td>
</tr>
<tr>
<td>Harbor Capital Appreciation NV</td>
<td>HLCAX</td>
</tr>
<tr>
<td>Harbor Capital Appreciation AGM</td>
<td>HMCAX</td>
</tr>
<tr>
<td>CM Small Company Value</td>
<td>ICECX</td>
</tr>
<tr>
<td>American Funds EuroPacific</td>
<td>AEPFX</td>
</tr>
<tr>
<td>American Funds EuroPacific GR R1</td>
<td>REPAX</td>
</tr>
<tr>
<td>American Funds EuroPacific GR R2</td>
<td>REXRX</td>
</tr>
<tr>
<td>American Funds EuroPacific GR R3</td>
<td>REXRX</td>
</tr>
<tr>
<td>American Funds EuroPacific GR R4</td>
<td>REPFX</td>
</tr>
<tr>
<td>American Funds EuroPacific GR R5</td>
<td>REPFX</td>
</tr>
<tr>
<td>American Funds EuroPacific GR R6</td>
<td>NEROX</td>
</tr>
<tr>
<td>AIMCO Total Return</td>
<td>PTRRX</td>
</tr>
<tr>
<td>AIMCO Total Return ADR</td>
<td>PTRRX</td>
</tr>
<tr>
<td>AIMCO Total Return D</td>
<td>PRDX</td>
</tr>
<tr>
<td>AIMCO Total Return INST</td>
<td>PTRRX</td>
</tr>
<tr>
<td>AIMCO Commodity Real Return Fund Inst</td>
<td>PCNX</td>
</tr>
<tr>
<td>AIMCO Commodity Real Return Strategic</td>
<td>PNX</td>
</tr>
<tr>
<td>AIMCO Commodity Real Return Strategic 2</td>
<td>PNX</td>
</tr>
<tr>
<td>Schwab Retirement Money Market</td>
<td>SWRLX</td>
</tr>
<tr>
<td>Schwab Value Advantage Money Fund - IN, SHRS</td>
<td>SWVNX</td>
</tr>
<tr>
<td>Schwab Retirement Advantage Money Fund</td>
<td>SWVNX</td>
</tr>
<tr>
<td>Schwab Value Advantage Money Fund - SE, SHRS</td>
<td>SWVNX</td>
</tr>
<tr>
<td>Fidelity Opportunity Fund</td>
<td>CMIXX</td>
</tr>
<tr>
<td>Vanguard S&amp;P 500 Index</td>
<td>VSPXX</td>
</tr>
<tr>
<td>Vanguard Institutional Index</td>
<td>VNX</td>
</tr>
<tr>
<td>Dodge &amp; Cox International</td>
<td>DODFX</td>
</tr>
<tr>
<td>Fidelity Floating Rate High Income</td>
<td>FFHXX</td>
</tr>
<tr>
<td>ING Global Real Estate</td>
<td>INGLX</td>
</tr>
<tr>
<td>ING Global Real Estate Fund</td>
<td>INGLX</td>
</tr>
<tr>
<td>ING Global Real Estate W</td>
<td>INRLX</td>
</tr>
<tr>
<td>Three Peaks High Income</td>
<td>ATPFX</td>
</tr>
<tr>
<td>Artisan Mid Cap</td>
<td>ARTMX</td>
</tr>
</tbody>
</table>
DUE DILIGENCE

- Know and understand your Fiduciary duties and responsibilities
- Delegate to prudent experts
- Monitor experts and costs
- Create a plan ... then follow the plan
- Document, document, document
  - Maintain a Permanent Fiduciary File that documents due diligence for all decision making and fiduciary process
REGULATORY REFERENCES

- Internal Revenue Code
- State Statute
- ERISA
REGULATORY REFERENCES

• Internal Revenue Code
  – IRC § 401(a) and 457(b)

• Colorado State Statute
  – Uniform Prudent Investors Act (UPIA) § 15-1

• Department of Labor (DOL) ERISA
  – Employee Retirement Income Security Act (‘74)
  – § 404(c)
PRUDENT INVESTOR RULE

• UPIA Section 2(a)

“A trustee shall invest and manage trust assets as a prudent investor would...”
UPIA REFERENCED IN COLORADO STATUTES

- Uniform Prudent Investor Act
  - UPIA (CRS Title 15, Article 1.1, Sections 101-115)
  - UPIA applies to all fiduciaries (CRS 15-1-304.1)
“The test of prudence is one of conduct and not performance.”
Restatement of Trusts (Third): Prudent Investor Rule

When enforcing these fiduciary duties ...
“the court focuses not only on the merits of the transaction, but also on the thoroughness of the investigation into the merits of the transaction.”
Donavan v. Cunningham, 716 F.2d 1455, 1467 (5th Cir.) (1983)
FIDUCIARY RESOURCES

• Fiduciary360 – Center for Fiduciary Studies
  – www.fi360.com
• U.S. Department of Labor Employee Benefit Security Administration
  – www.dol.gov/ebsa
• Strategic Ethos
  – www.3ethos.org
QUESTIONS?