

# Investment Review Checklist for 401(k) Plan Committees

CAROL I. BUCKMANN, OSLER, HOSKIN & HARCOURT LLP  
WITH PRACTICAL LAW EMPLOYEE BENEFITS & EXECUTIVE COMPENSATION

This Checklist provides a list of issues that an investment or administrative committee of a 401(k) plan governed by the Employee Retirement Income Security Act of 1974 (ERISA) should consider, including those raised by the US Supreme Court's recent decision in *Tibble v. Edison Int'l*.

This Checklist provides a list of issues regarding the investment of plan assets that an investment or administrative committee of a 401(k) plan governed by the Employee Retirement Income Security Act of 1974 (ERISA) should consider in light of the US Supreme Court's recent decision in *Tibble v. Edison Int'l* (No. 13-5502015, 2015 WL 2340845 (May 18, 2015)). The Court in *Tibble* held that the six-year statute of limitations under ERISA for a breach of fiduciary duty claim is triggered by the fiduciary's continuing duty, and in this case, failure, to monitor plan investments, provided that the breach (such as the failure to replace an imprudent fund) occurred within six years of suit. For more information, see *Legal Update, Supreme Court Holds that ERISA's Six-Year Statute of Limitations Triggered by Continuing Duty to Monitor* (<http://us.practicallaw.com/1-613-5525>).

This Checklist can be used in conjunction with the *Standard Documents, Investment Committee for Defined Contribution Plan Charter* (<http://us.practicallaw.com/3-504-3644>) and *Investment Policy Statement for Defined Contribution Plan* (<http://us.practicallaw.com/9-503-1624>).

Plan committee members who do not themselves have the expertise to conduct a review of the plan's investments should retain outside fiduciary advisers to assist in the process.

## REVIEW PERFORMANCE OF CURRENT FUNDS (QUARTERLY)

On a quarterly basis, the committee responsible for the selection and monitoring of investments in a 401(k) plan should review the performance of the investment funds available in the plan, including:

- Review reports prepared by outside advisers to evaluate current performance.
- Evaluate the current funds to determine if they represent all desired asset classes. Compare the desired asset classes from

the plan's investment policy statement (see *Standard Document, Investment Policy Statement for Defined Contribution Plan* (<http://us.practicallaw.com/9-503-1624>)).

- Determine if there has been "style drift" since funds were selected. If so, decide whether action should be taken to add funds to watchlist or replace them.
- Review performance of investment funds versus peer funds and benchmark funds.
- Consider whether there too many proprietary or affiliated funds. A proprietary fund is an investment fund that is offered by the same entity that acts as the investment consultant or investment manager to the plan. An affiliated fund is any of that service provider's own family of funds. (Some advisers believe that it is unlikely that a menu heavily weighted in proprietary or affiliated funds will have the best available investments in each class.)
- Consider alternatives to money market funds. Recent Securities and Exchange Commission (SEC) rules on money market funds that permit floating net asset values (NAVs) and redemption restrictions become effective in 2016 (see *Practice Note, Investment Company Act of 1940 Exceptions: Guide for Transactional Lawyers: What is a Cash Item under the Balance Sheet Test* (<http://us.practicallaw.com/1-504-8727#a957378>)).
- Watchlist update, including:
  - review funds previously on the watchlist for possible removal; and
  - discuss reasons any new funds are to be placed on the watchlist.
- Evaluate if better funds are available to replace current funds, even if not on a watchlist.
- If the plan does not offer low-cost index funds as part of its investment menu, consider adding these funds.
- Review special considerations for direct investments, including partnerships. For a sample side letter with a limited partnership in which a plan invests, see *Standard Document, Side Letter, Investment in an ERISA Plan Assets Fund* (<http://us.practicallaw.com/8-580-1826>).
- Review plan asset and related party issues to avoid prohibited transactions. For more information, see *Practice Notes, ERISA Plan Asset Rules* (<http://us.practicallaw.com/0-506-0461>), *Negotiating Alternative Investments: an ERISA Perspective* (<http://us.practicallaw.com/7-551-4246>) and *Prohibited Transactions and Exemptions under ERISA and the IRC* (<http://us.practicallaw.com/9-526-8386>).



- Review performance of investment managers against investment guidelines. See *Practice Note, Selecting and Hiring an Investment Manager* (<http://us.practicallaw.com/5-504-8278>). For a sample investment management agreement for a QPAM, see *Standard Document, Qualified Professional Asset Manager (QPAM) Agreement* (<http://us.practicallaw.com/4-549-0505>).
- Ensure that the committee is aware of the fee structure and glide path of target-date funds (see *Practice Note, Qualified Default Investment Alternatives (QDIAs): Life-cycle or Target-date Funds* (<http://us.practicallaw.com/0-525-5133>)).

### REVIEW FEES OF CURRENT FUNDS (RECOMMENDED QUARTERLY)

On a quarterly or semi-annual basis, the committee responsible for the selection and monitoring of investments in the plan should review the fees associated with the investment funds available to ensure that the fees are reasonable in relation to the services provided, including:

- Ensure that revenue sharing is being taken into account when evaluating investment-related and service provider fees. For more information on revenue sharing and fees, see *Practice Notes, Service Provider Disclosure Requirements for Pension Plans: Disclosure of Recordkeeping Services Paid Through Revenue Sharing* (<http://us.practicallaw.com/7-508-2407>) and *Disclosure Requirements for Participant-Directed Defined Contribution Plans: Administrative Expense Information* (<http://us.practicallaw.com/7-506-5295>).
- Review all direct and indirect fees. For information on what is considered direct and indirect compensation, see *Practice Note, Service Provider Disclosure Requirements for Pension Plans: Direct Compensation* (<http://us.practicallaw.com/7-508-2407>) and *Indirect Compensation* (<http://us.practicallaw.com/7-508-2407>). Direct and indirect compensation include charges such as, for example:
  - management and advisory fees;
  - custody fees;
  - 12b-1 fees;
  - loads; and
  - commissions.
- For investments made through annuity contracts or target-date funds, take into account fees that may be generated at all levels.
- Ensure that investments are being offered in the cheapest possible available share class. The Court of Appeals in *Tibble* found a breach of the plan fiduciary's duty to monitor because, in part, the fiduciary did not remove three retail class mutual funds when it became aware that materially identical institutional mutual funds with lower expense ratios were available. The US Supreme Court did not rule on whether there was a fiduciary breach regarding the three funds that were in the plan for more than six years, but remanded the case for further proceedings. These proceedings will presumably be consistent with the Court of Appeals' earlier ruling (*Tibble*, 2015 WL 2340845 (May 18, 2015)).
- Review fees payable from plan assets to determine that no settlor expenses are being paid from the plan. For more information, see *Practice Note, Paying Employee Benefit Plan Expenses* (<http://us.practicallaw.com/4-504-8434>) and *Paying Employee Benefit Plan Expenses Chart* (<http://us.practicallaw.com/0-503-5315>).

### INVESTMENT SERVICE PROVIDER PERFORMANCE REVIEW (AT LEAST ANNUALLY)

On a regular basis, and no less frequently than annually, the committee should review the performance of the investment service provider to fulfill its fiduciary obligation to prudently select and monitor plan service providers (see *Practice Note, Negotiating ERISA Service Provider Agreements: Monitoring the Service Provider* (<http://us.practicallaw.com/8-517-8904#a1011573>)). This includes considering the following issues:

- Evaluate if the outside investment adviser should acknowledge fiduciary status. To consider the impact of the Department of Labor's proposed new definition of fiduciary and how it impacts plan service providers, see *Practice Note, Definition of Fiduciary* (<http://us.practicallaw.com/3-610-6145>). For a savings clause that can be used in service provider contracts before this rule becomes final, see *Standard Clause, Fiduciary Definition Savings Clause* (<http://us.practicallaw.com/2-612-3485>).
- Ensure that the investment adviser provides written performance reports in advance of meetings.
- Ensure that the investment adviser or manager reviews fees as well as fund performance.
- Review the investment adviser's or manager's fees against an appropriate benchmark.
- Request that the investment adviser inform committee members when plan assets increase in value to make institutional or other cheaper share classes available.
- Determine if the investment adviser or manager has provided any required ERISA Section 408(b)(2) disclosures (29 U.S.C. § 1108(b)(2)). If so, evaluate adequacy of disclosure. For more information, see *Practice Note, Service Provider Disclosure Requirements for Pension Plans* (<http://us.practicallaw.com/7-508-2407>).
- Evaluate the investment return of funds managed by fiduciary investment managers against benchmarks.
- Review the fees to ensure that they are still reasonable in relation to the services provided.
- If any personnel from the service provider responsible for advising the plan or plan has changed, evaluate the adequacy of the new personnel.

### ONGOING REVIEW (AT LEAST ANNUALLY)

The committee should undertake an ongoing review of the plan's investment funds, fees and service providers regularly and on at least an annual basis. This ongoing review should include a review of whether better investment choices are available and issues such as:

- Determine whether annual participant ERISA Sections 404(a) (29 U.S.C. § 1104(a)) and 404(c) (29 U.S.C. § 1104(c)) disclosures are compliant and understandable. For information on ERISA Section 404(a) disclosures, see *Practice Note, Disclosure Requirements for Participant-Directed Defined Contribution Plans* (<http://us.practicallaw.com/7-506-5295>) and on ERISA Section 404(c) disclosures, see *Practice Note, Qualified Default Investment Alternatives (QDIAs)* (<http://us.practicallaw.com/0-525-5133>), *ERISA Section 404(c) Checklist* (<http://us.practicallaw.com/6-503-3021>) and *Standard Document, ERISA Section 404(c) Policy Statement* (<http://us.practicallaw.com/8-503-1926>).

- Consider if changes should be made to the investment policy statement or, if separate, the fee policy statement. For a sample investment policy statement, see *Investment Policy Statement for Defined Contribution Plan* (<http://us.practicallaw.com/9-503-1624>).
- Consider if changes should be made to the investment guidelines provided to any investment manager. See *Practice Note, Selecting and Hiring an Investment Manager* (<http://us.practicallaw.com/5-504-8278>).
- Consider if the plan's QDIA should be changed (see *Practice Note, Qualified Default Investment Alternatives (QDIAs)* (<http://us.practicallaw.com/0-525-5133>) and *Standard Document, Qualified Default Investment Alternative (QDIA) Notice* (<http://us.practicallaw.com/4-517-3946>)).
- Ensure that the appropriate benchmarks are being used to measure performance.
- Confirm that a formal benchmarking report is requested and prepared at least every few years.
- Determine when the last formal request for proposal (RFP) was completed to evaluate fees and services compared to competitors. To review what should be included in an RFP, see *Request for Proposal (RFP) Checklist for Retirement Plans* (<http://us.practicallaw.com/7-518-7857>).
- Consider what action should be taken if the last RFP showed high service provider fees, including:
  - renegotiating the current fee arrangement;
  - determining if the committee can justify higher fees due to superior performance; and
  - considering whether different vendors should be evaluated.
- Determine if the plan's ERISA bonding coverage needs to be increased. For more information, see *Practice Note, ERISA Bonding Requirements* (<http://us.practicallaw.com/9-503-3454>).
- Ensure that the Form ADV has been provided by managers. For more information, see *Standard Document, Qualified Professional Asset Manager (QPAM) Agreement: Drafting Note: Form ADV* (<http://us.practicallaw.com/4-549-0505#a532940>).
- Ensure that managers have not been subjected to disciplinary action.
- Request updated prospectuses and other fund reports, as necessary.
- Confirm the existence and consider the adequacy of the fiduciary liability insurance coverage for the plan's investment professionals. For more information, see *Practice Note, Insurance Policies and Coverage: Overview* (<http://us.practicallaw.com/9-505-0561>).
- Review every manager's trading and brokerage practices.

## BEST PRACTICES

The committee should be able to demonstrate that it followed a prudent process in evaluating investments and fees in the event investments or fees are challenged in litigation or DOL audits. To adequately demonstrate this process, it should consider the questions and items noted in this Checklist, as well as these best practices:

- Carefully document all issues considered at the committee meetings and the reasons for the decisions made.
- Set out these issues in written meeting agendas and minutes.
- Retain written agendas and meeting minutes in the plan's records.
- If the committee lacks the expertise to do a comprehensive review of all issues, consider retaining an independent adviser who acknowledges ERISA fiduciary status in writing to assist the committee in the performance of its duties.
- Consider implementing a fiduciary education program for the committee members to ensure that all the committee members are familiar with their responsibilities (see *Practice Note, ERISA Fiduciary Training* (<http://us.practicallaw.com/8-518-9686>)).

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