Overcome the Increased Scrutiny of Your Organization's Retirement Plan

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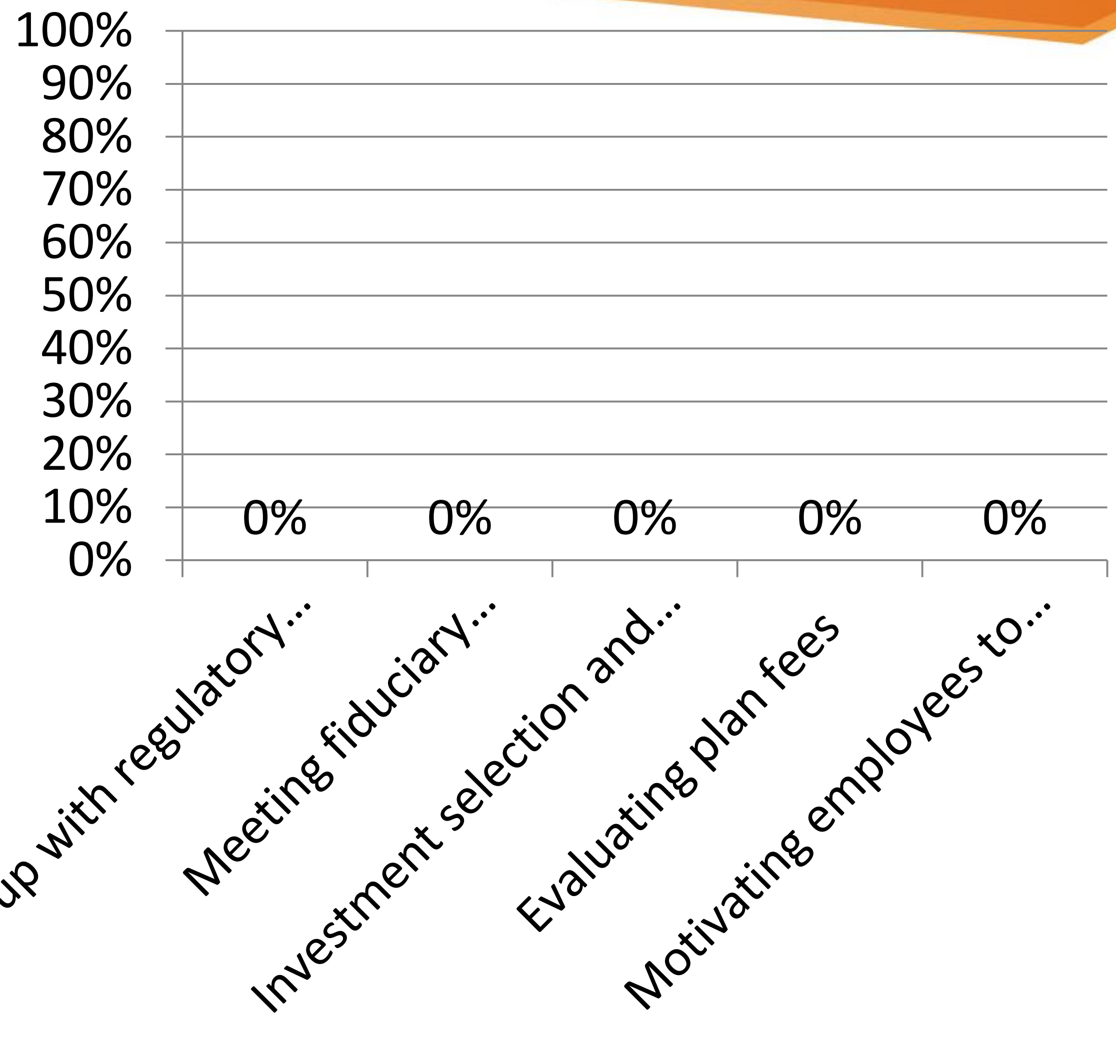
Goals for Today's Presentation

- Understand your fiduciary responsibility
- Hear about recent and upcoming regulations
- Discuss best practices for managing decisions related to your organization's retirement plan
- Learn how your peers are handling these issues
- Encourage collaboration and interaction

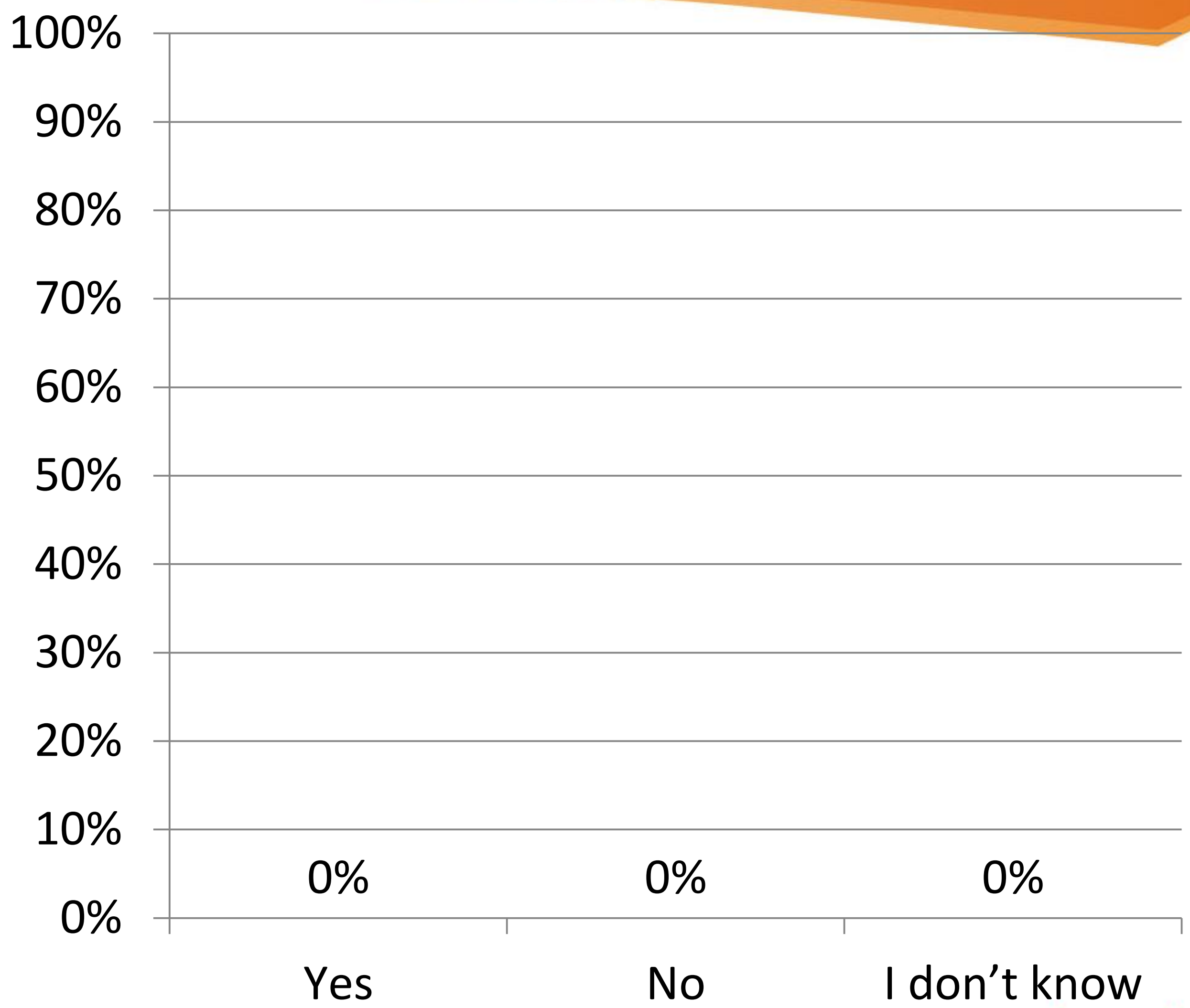
What is the biggest challenge you face as a plan sponsor?

1. Keeping up with regulatory changes
2. Meeting fiduciary responsibilities
3. Investment selection and monitoring
4. Evaluating plan fees
5. Motivating employees to participate



Do you consider yourself a plan fiduciary?

1. Yes
2. No
3. I don't know



Examples of Plan Fiduciaries at Associations

- Executive Director
- Chief Financial Officer
- Chief Operating Officer
- Director of Finance
- Director of Human Resources
- Director of Operations
- Board Members
- Investment Committee Members
- Finance Committee Members

However, it is important to note that fiduciaries are determined by their actions not by their title.

What does it mean to be an ERISA Fiduciary?

An ERISA fiduciary is someone who:

1. *Exercises discretionary authority or control over plan management or administration; or*
2. *Exercises any authority or control over management or disposition of plan assets; or*
3. *Renders investment advice for a fee.*

- The responsibilities of fiduciaries have been described as the highest known to law
- Fiduciaries are held to a “prudent expert” standard
- Fiduciaries can be held personally liable for losses that are attributed to their mismanagement

Penalties For Breaching Fiduciary Duties

1. ERISA Section 502(a) **grants participants authority to bring suit** on behalf of a plan against a plan fiduciary for breaching its fiduciary duties under ERISA.

2. ERISA Section 409 makes a fiduciary **“personally liable”** for a fiduciary breach and requires such fiduciary “to make good to the plan any losses to the plan resulting from” a breach.

3. ERISA Section 502(I) imposes a **20% civil penalty** on amounts recovered pursuant to a settlement with the DOL.

ERISA: Summary of Standards of Conduct

- Act solely in the best interest of plan participants and their beneficiaries and with the exclusive purpose of providing benefits to them;
- Act with care, skill, prudence, and diligence
- Manage the plan in accordance with plan documents (as long as they are consistent with ERISA)
- Diversify plan investments to help minimize risk of loss
- Ensure plan expenses are reasonable

ERISA Sections Covering Plan Fees

1. ERISA Section 404 –
   - Imposes a duty on plan fiduciaries to act prudently and solely in the interest of plan participants
   - Authorizes use of plan assets to pay "reasonable" plan expenses
   - Fiduciary's actions will be judged against a hypothetical "prudent expert" standard

2. ERISA Section 403 –
   - Requires plan assets to be held in a qualifying trust *"…..for the exclusive purposes of providing benefits and* ***defraying reasonable expenses*** *of administering the plan."*

3. ERISA Section 406 –
   - Prohibits plan fiduciaries from causing certain prohibited transactions (*e.g.* receipt of excessive compensation for services).
   - ERISA Section 408(b)(2) exemption allows use of plan assets to pay fees for "services that are necessary" for plan operation, and only if no more than "reasonable compensation" is paid for them.

Department of Labor's Efforts to Improve Fee Transparency

DOL's three-pronged approach:

- Plan fee disclosures to regulators (DOL/IRS): New Schedule C on Form 5500 effective for 2009 plan year
- Service provider disclosures to plan sponsors : 408(b)(2) effective July 1st 2012
- Participant disclosures: 404(a)(5) effective August 30th 2012

The DOL has increased their plan auditing efforts by adding a significant number of plan auditors and beginning audits of 403(b) plans.

Why Is The Department of Labor Focused on Fees?

- Majority of fees are paid out of plan assets by participants
- Plan fiduciaries are required by ERISA to monitor these fees
- Historical lack of transparency in disclosures from retirement plan service providers
- Various fees are undisclosed and embedded within investment vehicles on the plan's menu
- Revenue sharing between plan recordkeepers and investment managers creates a conflict of interest
- Due to the lack of fee transparency in the retirement plan industry, it has been difficult for plan fiduciaries to effectively fulfill their duties
- Many lawsuits currently pending related to retirement plan fee issues
- With the new disclosures, plan fiduciaries will have the information they need to evaluate their plan fees – this evaluation needs to occur and should be documented

408(b)(2) Exemption From Prohibited Transaction

The following plan expenses may generally be paid out of plan assets provided the plan document permits it and the expenditure is prudent and the amount reasonable:

- Recordkeeping
- Safekeeping of plan assets (i.e. custodial services)
- Investment management
- Investment advisory
- Participant communications, advice, and education
- Required testing
- Legally required reporting (e.g. 5500)
- Legal services related to plan fiduciary issues
- Audit
- Bonding

408(b)(2) Amendment: Service Provider Disclosures to Plan Sponsors

- Amended regulation 408(b)(2) to provide additional disclosure requirements as a condition for a reasonable contract or arrangement

- Applies to ERISA-covered defined benefit and defined contribution pension plans

- Requires covered service providers (CSPs) to provide responsible fiduciaries with information they need to:
  - Assess reasonableness of total compensation received by the CSP, both direct and indirect, received by the CSP, its affiliates, and/or subcontractors;
  - Identify potential conflicts of interest; and
  - Satisfy reporting and disclosure requirements under Title I of ERISA.

Section 404(a)(5): Plan Sponsor Disclosures to Plan Participants

- Section 404(a)(5) requires plan sponsors to disclose investment-related information and expenses charged to participant-directed accounts
- Going forward, new participants to the plan should receive this disclosure on or before the date on which they can first direct their investments
- Quarterly information regarding the actual fees deducted from a participant’s account
- Applies to ERISA-covered defined contribution retirement plans, such as 401(k) plans

Tussey v. ABB, inc.

- First 401(k) fee class action to be tried and decided on its merits
- Missouri federal district court ruled that employer plan sponsor breached its ERISA fiduciary duties and must pay $35.2million for:
  - Failing to monitor the dollar amount of recordkeeping fees, and to cap revenue sharing payments at a reasonable level
  - Failing to negotiate rebates to offset or reduce the cost of providing administrative services to plan participants; and
  - Replacing a balanced fund with a target date fund, not because the balanced fund was deficient, but rather, because the target date fund generated more revenue sharing for the service provider.
- Court emphasized that if the fiduciary opts for revenue sharing, "it also must have gone through a deliberative process for determining why such a choice is in the Plan's and participants' best interest."
- The Plan's Investment Policy Statement ("IPS") required that revenue sharing "be used to offset or reduce the cost of providing administrative services to plan participants."
- Court held that IPS is governing plan document and that employer violated its ERISA Section 404(a)(1)(D) statutory fiduciary duty to comply with its terms.

Tibble v. Edison International

- 401(k) fiduciaries breached duties by using retail class mutual funds without investigating institutional class funds.
- 404(c) does not protect fiduciaries from imprudent an fund lineup.
- The plan sponsor relied on a reputable, outside investment advisor, but this did not absolve the plan sponsor of the duty to probe and question the advice received.

2013 Regulatory Agenda

According to the agendas of the U.S. Treasury and the Department of Labor (DOL), 2013 could be a busy year for regulatory actions which impact defined contribution plans. Below are the relevant items from each agenda:

U.S. Treasury's 2012 – 2013 Priority Guidance Plan

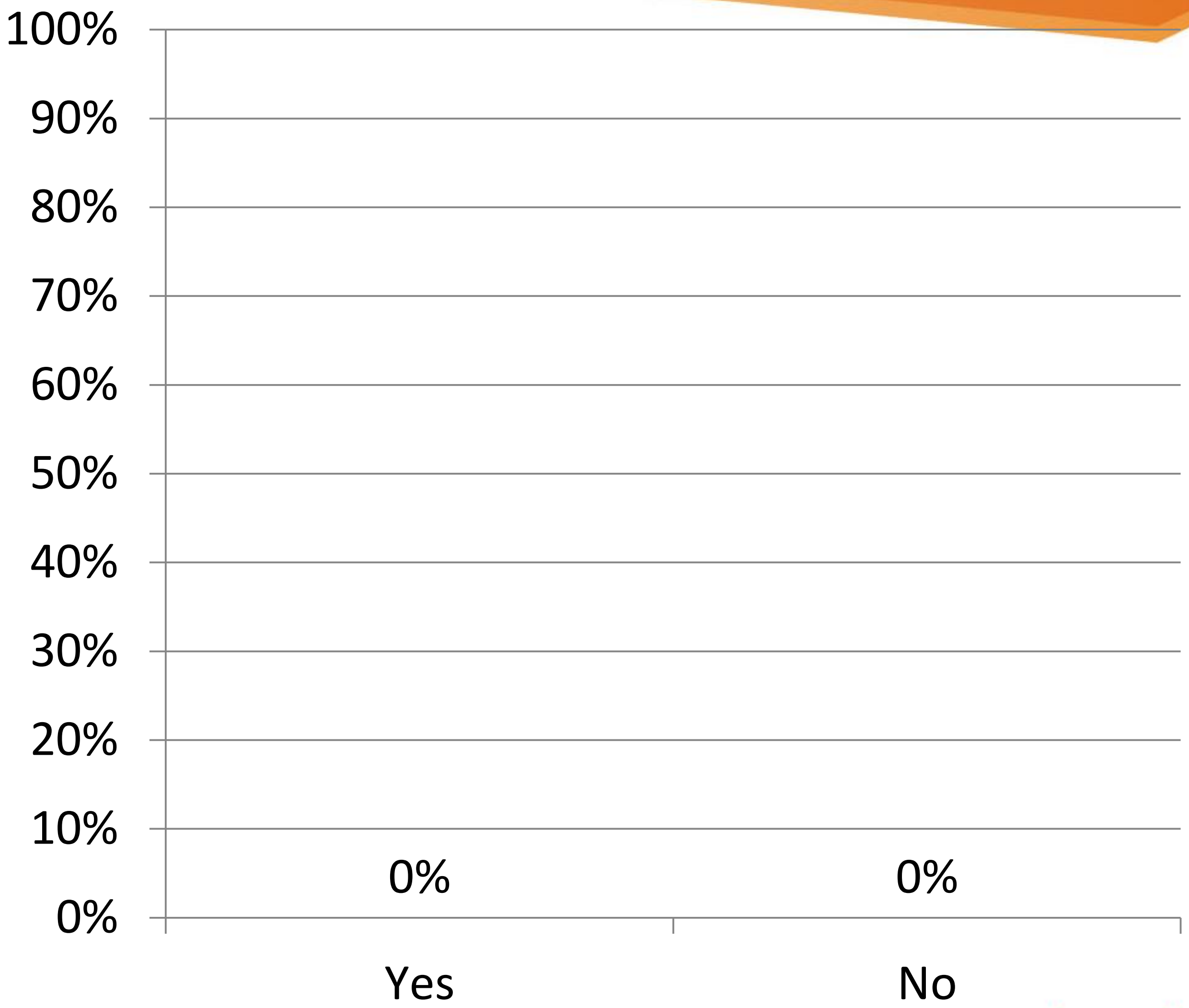
- Final regulations under Section 401(a)(9) on deferred annuities
- Guidance to facilitate rollovers into retirement plans
- Additional guidance on issues relating to lifetime income from retirement plans

Employee Benefit Security Administration's (EBSA) Semi-Annual Regulatory Agenda

- Qualified Default Investment Alternative (QDIA) disclosures
- Lifetime income options
- Definition of a fiduciary

Does your plan offer target date funds?

1. Yes
2. No



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Target Date Funds

- 2008 market collapse exposed investor misconceptions about Target Date Funds (TDFs)
- SEC-sponsored study confirmed the following
  - Many believe the target date is the point at which the fund is most conservative and the allocation stops changing
  - Only 36% of respondents correctly indicated that a target date fund does not provide guaranteed income in retirement
  - More than half think all target date funds with the same year have the same mix of stock and bond investments
- Highlights of proposed regulations related to TDF participant disclosures
  - Requires asset allocation to be included
  - Table, chart, or graph depicting funds allocation over time along with final allocation (often referred to as glide path)
  - Statement that the decision to invest in target date funds should not be solely based on age or retirement date, the funds are not a guaranteed investment, and the asset allocation is subject to change
- DOL published “Target Date Retirement Funds – Tips for ERISA Plan Fiduciaries” earlier this year.
  - Establish a process for selecting and monitoring TDFs.
  - Understand variations in glide paths.
  - Review fees and expenses.
  - Develop effective employee communications.

Evolution of AAMI's 401(k) Plan

The Issues:

- Investment Policy did not include the appropriate level of detail
- Plan investments and service providers were not receiving proper oversight
- Service issues with existing record-keeper
- Lack of fee transparency
- Plan permitted self-directed brokerage accounts
- No employee education

The Solution: Improving Plan Oversight

- Worked with ERISA Attorney and Investment Advisor to establish a new Investment Policy
- Tasked Executive Committee with responsibility for overseeing the plan's investment options
- Began reviewing plan investment monitoring reports during quarterly Investment Committee meetings
- Began conducting annual plan benchmark reviews of fees, plan design, and participant success measures
- Froze contributions to self-directed brokerage accounts
- Ongoing challenge: Finding people who left years ago; staying abreast of obligations – new and old (constant vigilance: is there anything else we need to do?)

The Solution: Addressing Service Provider Issues

- Conducted search for a new plan record-keeper
- Focused search on record-keepers that specialize in servicing plans similar in size to AAMI
- Developed scoring matrix that gave appropriate weighting to areas that were important to AAMI: Fiduciary support, fee transparency, participant education and communications
- Identified finalists for in-person presentations
- Made selection and initiated transition process

The Solution: Participant Education

- Lunch and learn opportunities for staff with representatives from the Plan's Record-keeper and Investment Advisor

- Consistent message which encourages participation in the plan and attendance at retirement plan education meetings

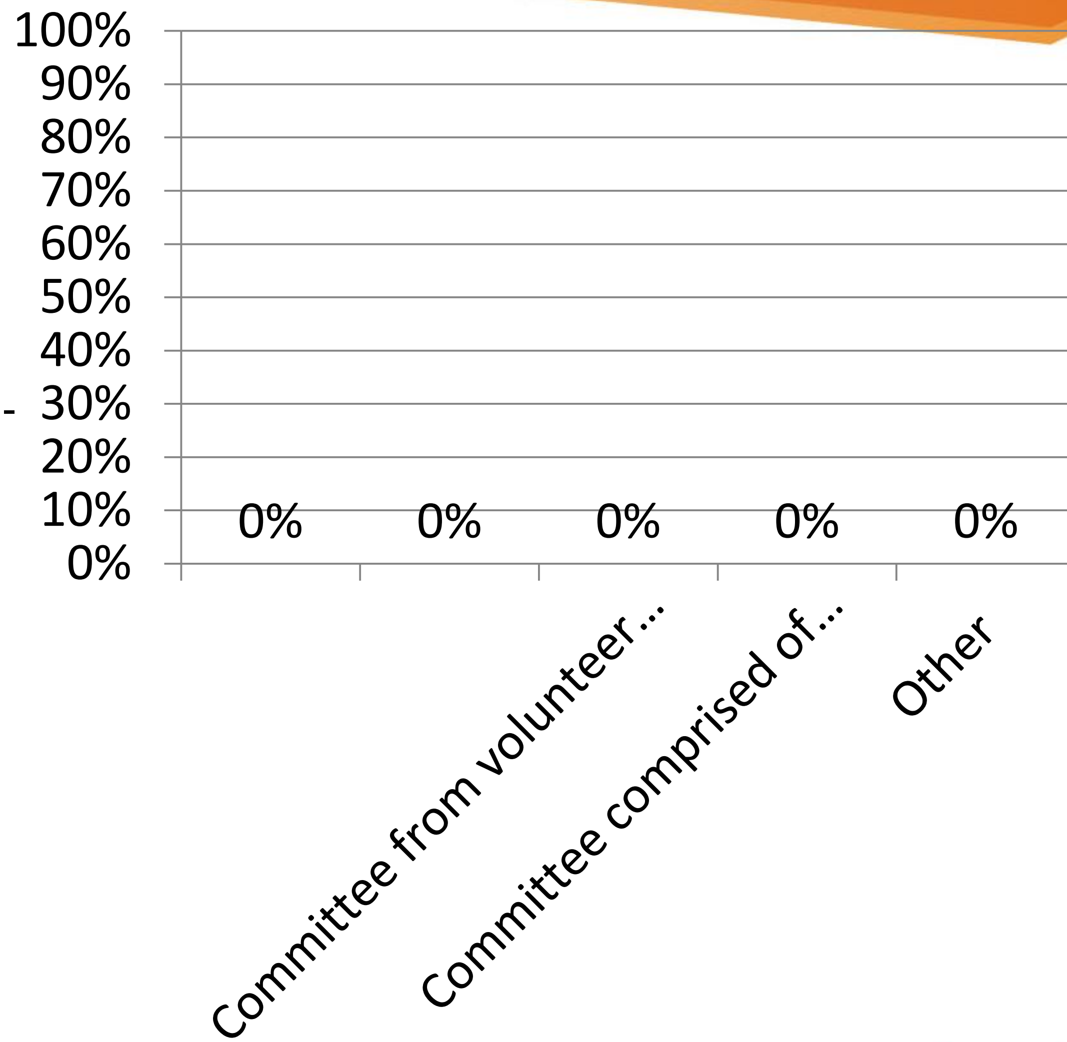
- Access to appropriate tools and resources

Best Practices

- Governance and Plan Oversight
- Investment Policy
- Monitoring Investment Options
- Evaluating Fees
- Plan Benchmarking
- Documentation

Who at your organization has primary oversight responsibility of your retirement plan?

1. Key staff member(s) from Finance
2. Key staff member(s) from Human Resources
3. Committee from volunteer leadership
4. Committee comprised of cross-section of employees
5. Other



Staff vs. Committee Roles

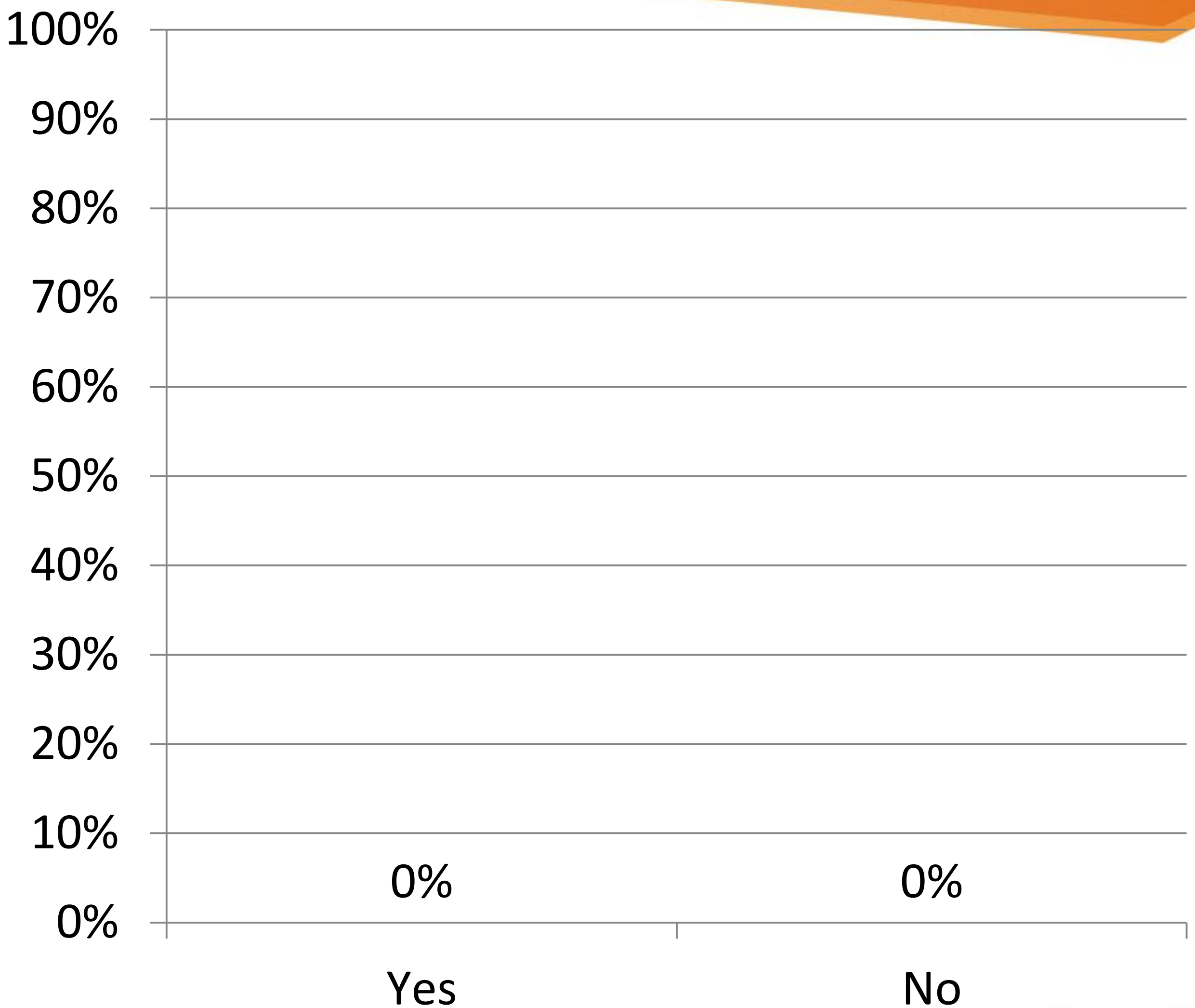
- No “one size fits all” approach

- Common staff roles
  - Plan administration
  - Employee communications
  - Hiring service providers
  - Disseminating important information to Committee members

- Common Committee roles
  - Approving the Investment Policy
  - Reviewing investment options
  - Approving changes to the investment menu
  - Benchmarking fees

Does your organization have an Investment Policy for your defined contribution plan?

1. Yes
2. No



Developing and Updating the Investment Policy

- Duties and responsibilities of all parties involved:
  - Staff
  - Committee
  - Record-keeper
  - Investment Managers
  - Investment Advisor

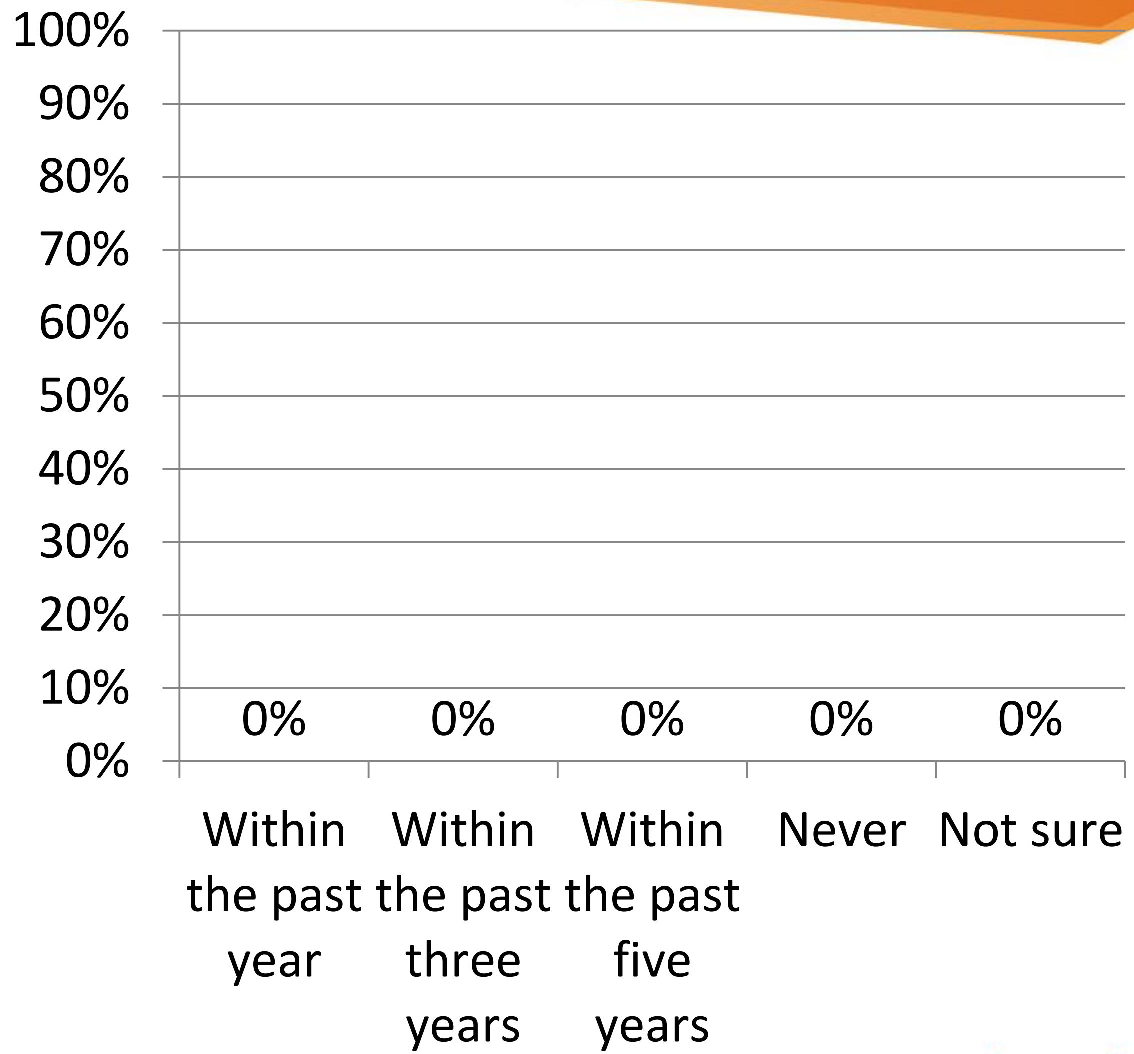
- Asset classes and investment categories offered:
  - Core investment menu
  - Qualified Default Investment Alternative (i.e. – Target Date Funds)
  - Index funds

- Procedures for controlling and accounting for investment expenses:

- Monitoring criteria for investment options and service providers

When was the last time your organization benchmarked or reviewed retirement plan fees?

1. Within the past year
2. Within the past three years
3. Within the past five years
4. Never
5. Not sure



Benchmarking Plan Fees

- Determining the benchmark group
  - Plan assets and number of participants
  - Industry
  - Necessary sample size

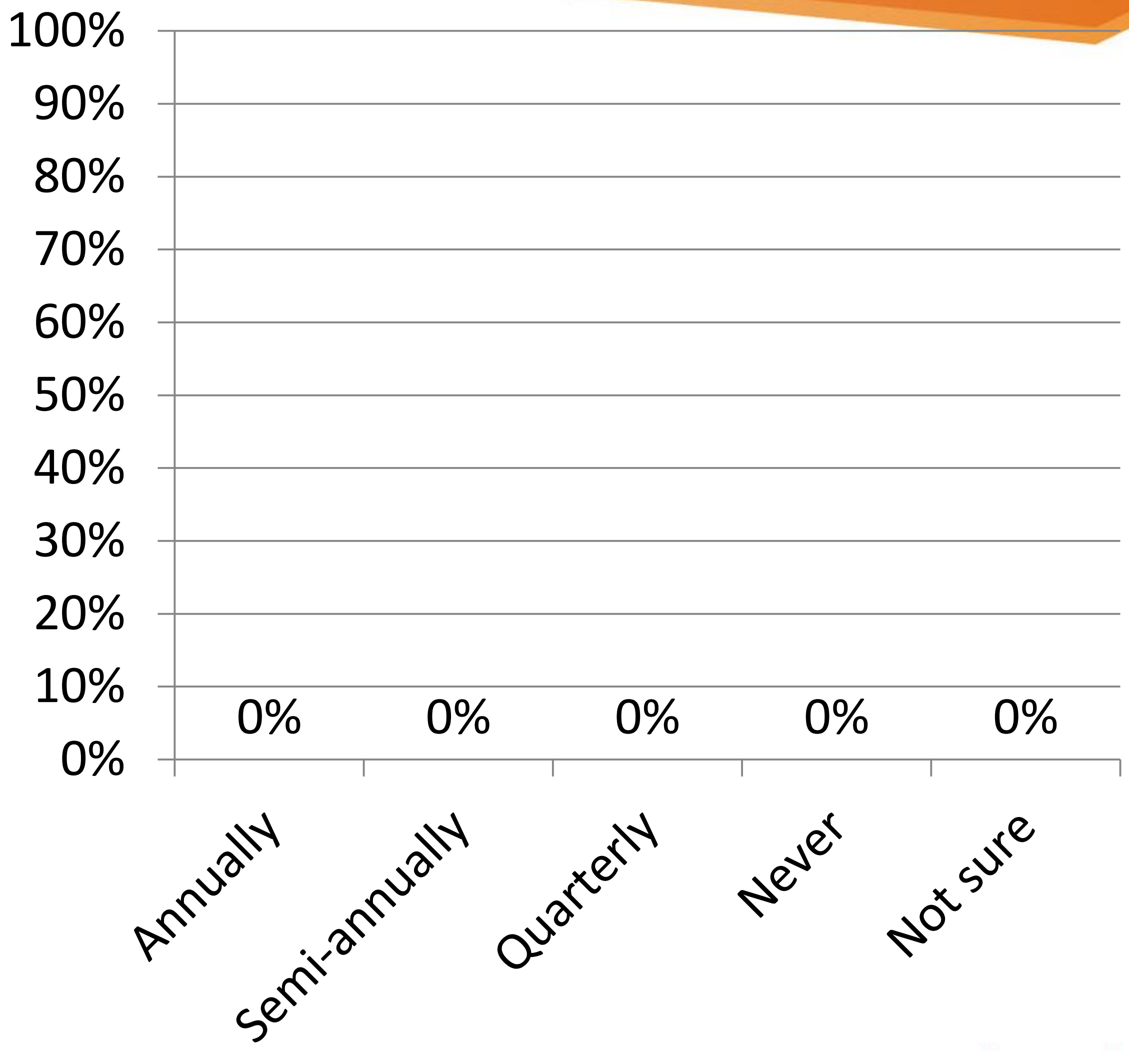
- Aggregating fees into different categories
  - Recordkeeping
  - Investment management
  - Advisory

- Leveraging benchmark results
  - Negotiating lower fees
  - Determining if a provider search is necessary

- Other purposes of plan benchmarking
  - Investment menu offerings
  - Plan design features
  - Participant statistics

How often does your organization formally review the investment options offered to employees?

1. Annually
2. Semi-annually
3. Quarterly
4. Never
5. Not sure



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Evaluating Investments

- Periodic evaluation (i.e. quarterly)
- Determine appropriate benchmarks and peer groups
- Quantitative measures
  - Performance vs. benchmark and/or peers over different periods
  - Risk-adjusted measures
  - Expenses
- Qualitative measures
  - Changes in ownership and/or management team
  - Strategy/process
  - Style consistency
- Different evaluation for different types of investments
  - Actively managed options
  - Passive indexed options
  - Target date funds
  - Stable Value/Guaranteed Funds

Different Types of Evaluation for Different Types of Investments

- Actively managed options
  - Performance against a specific benchmark or peers over a period of time
  - Risk measurement
  - Process that remains consistent with their stated investment objectives
  - Strength of management team and organization

- Passive indexed options
  - Variance from tracked index
  - Expense ratio

- Target date funds
  - Glide path approach
  - Management team
  - Underlying fund managers
  - Portfolio diversification
  - Active vs passive management
  - Strategic vs tactical asset allocation

Questions / Wrap Up

- The DOL has increased their oversight of employer-sponsored retirement plans and requirements for plan sponsors
- Further regulations and guidance are on the horizon
- ERISA outlines the responsibilities of plan fiduciaries
- Establish, follow, and document a clear and prudent process for decisions which impact plan participants

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