

Retirement Planning



Tips for IPS

Refining your 401(k) IPS and other fiduciary compliance tips

BY MICHAEL M. KANE

In evaluating many 401(k) plans over the past 25 years, I have found many fiduciary nonconformities and lots of opportunities for improvement, beginning with the investment policy statement.

I find many plans that have an IPS either don't apply it as it is written or it is missing several parts. An IPS should include:

- An executive summary of the IPS purpose and objectives.
- Roles and responsibilities for fiduciaries and nonfiduciaries supporting the portfolio.
- Investment selection criteria and

monitoring procedures (usually 11 to 12, including risk-adjusted criteria).

- Procedures for handling investment options that fail to satisfy established objectives.



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- Appropriate diversification within and among investment vehicles.

- Services to assist participants in making investment decisions.

- Procedures for controlling and accounting for expenses.

In many cases, I also find that if an investment policy committee exists, bylaws, minutes or documentation of the committee's activities

does not. It's also my experience that most committee members have received no formal fiduciary training — other than on the job — and therefore don't really understand their roles and responsibilities.

Even with plans that have an IPS that contains the guidelines listed above, they often fail to follow sound monitoring procedures for investments.

Some of the criteria used in monitoring investments are:

- Investment style (R2 and style drift).
- Performance (one-, three- and five-year performance vs. five-year up/down capture vs. peers).
- Risk/risk-adjusted factors (information ratio for three and five years, and beta for three and five years).

- Qualitative factors (longest-tenured manager greater than or equal to Morningstar, and net expense ratio is less than the average for their particular Morningstar category or asset class).

404(c) checklist

One of my other consistent findings is that there is no Department of Labor Regulation 404(c) checklist.

This regulation provides some minimization of fiduciary responsibility by plan fiduciaries with regards to investments if the checklist items are met. This checklist generally contains 20-25 items. Among them, the plan must:

- Be an "individual account plan," such as a 401(k).

- Permit participants to give instructions, written or otherwise, with respect to the investments of their accounts.

- Provide participants the opportunity to exercise control over the assets in their accounts.

- Provide participants the opportunity to receive written confirmation of investment instructions.

- Offer participants a choice from a broad range of investment alternatives.

- Feature alternatives that are diversified

and have materially different risk and return characteristics.

- Consider underlying investments of the look-through investment vehicles, determining whether the plan satisfies the diversification requirements, where look-through investment vehicles are available as investment alternatives to participants.

- Give participants the name, address and telephone number of the fiduciary responsible for receiving and carrying out participant investment instructions.

- Notify participants of any limitations on giving investment instructions under the terms of the plan, including those imposed by the recordkeeping system.

- Offer participants a written notice that the plan intends to comply with 404(c), usually found in the summary plan description.

- State that plan fiduciaries may be relieved of liability for losses due to participant investment direction.

- Provide participants with a copy of the

most recent prospectus received by the plan, immediately prior to or immediately following their initial investment in a fund, if the investment alternative is subject to the Securities Act of 1933.

- Record or log of participants' requests and how fulfilled. **—E.B.N.**

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The dreaded 'A' word: All you need to know about ERISA audits

BY JERRY KALISH

It's ERISA audit time again. Now that the regular tax season is over, accountants soon will be turning their attention to ERISA plan audits. If your retirement plan is subject to the audit requirements, here are the basics you should know — including how *not* to hire an auditor.

Basic audit requirements

Plan administrators of certain employee

benefit plans that file Form 5500 are required to attach an independent qualified public accountant's opinion. The independent qualified public accountant must examine the plan's financial statements and other records to determine whether the financial statements and schedules are presented fairly and in conformity with generally accepted accounting principles. Benefit plan service providers often refer to the accountant's re-

port and financial statements collectively as "the audit report."

Here are the basic rules that apply to the audit:

- Generally, federal law requires that an employee benefit plan with 100 or more participants have an audit report. The auditor engaged for the employee benefit plan audit must be licensed or certified as a public accountant by a state regulatory agency and

should not have any financial interests in the plan or the plan sponsor.

- The audit report will include an opinion on the following Form 5500 items:

1. The financial statements and schedules covered by the annual report.

2. The accounting principles and practices reflected in the report.

3. The consistency of the application of

[\(SEE AUDIT ON PAGE 40\)](#)