PRUDENT PRACTICES FOR

Fiduciary Advisers

Written by the Financial Planning Association

FPA Press

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The Financial Planning Association (FPA) is the membership association for the financial planning community. FPA is committed to providing information and resources to help financial planners and those who champion the financial planning process succeed. FPA believes that everyone needs objective advice to make smart financial decisions.

FPA Press is the publishing arm of FPA, providing current content and advanced thinking on technical and practice management topics.

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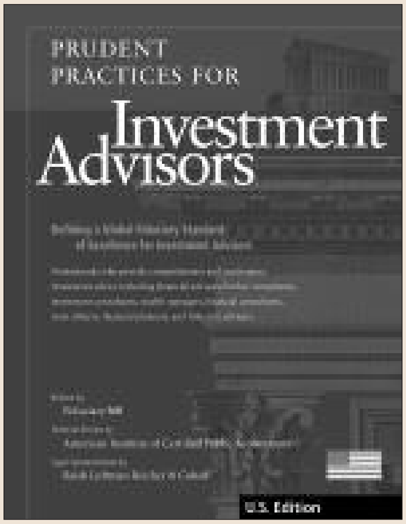
ISBN: 0-9753448-8-9
ISBN-13 978-0-9753448-8-0

Manufactured in the United States of America

Foreword

The first time I read Title VI of the Pension Protection Act (the section of the Act that deals with investment advice), the description of the roles and responsibilities of the newly defined "fiduciary adviser" struck me as being a melding of fiduciary practices with financial planning. I immediately called Marv Tuttle and Duane Thompson, and suggested that our two organizations, the Financial Planning Association and Fiduciary360, collaborate on a new industry handbook that would define the practices of the fiduciary adviser.

This handbook represents the unselfish efforts of a committee comprised of knowledgeable financial planning veterans. Their work began by reviewing the fiduciary practices outlined in the handbook, *Prudent Practices for Investment Advisors* (co-produced by Fiduciary360 and the AICPA, the 330,000-member American Institute of Certified Public Accountants), and deciding which were applicable to the "fiduciary adviser." They then developed additional practices to help define the fiduciary adviser's unique role, as defined by the Pension Protection Act.



The practices in this handbook represent the collective business judgment of the FPA task force, as opposed to just a summation of legal opinions and regulatory announcements. It should be stressed that the Department of Labor has yet to issue regulations which will describe in much greater detail the operations of the new prohibited transaction exemption of Section 601 of the Act. Therefore, this handbook should be considered a work in progress. It is likely that even when more details are released by the U.S. Department of Labor in the form of regulations, these will still lack the specificity found in this handbook. That's not unusual, for most regulators prefer that professionals take the lead in defining practices for their own industry group.

Fiduciary360 is proud of its association with FPA. At a time when fiduciary responsibility is critical, FPA has chosen to play a pivotal leadership role. The management of investment decisions is not an easy task, even for trained professionals; and a nearly impossible task for lay decision-makers such as the retirement plan participants. Since professional and lay decision-makers depend upon an assortment of industry vendors for assistance in managing investment decisions, there is an imperative that we all *foster and promote a culture of fiduciary responsibility*.

Donald B. Trone, AIFA®
CEO, Fiduciary360
January 2007

Preface

This handbook reflects a pressing need to address rapid changes in the financial services industry as the demand increases for investment advice for American workers. The strict fiduciary duties outlined under the Employee Retirement Income Security Act of 1974 for plan sponsors have, over the years—unintentionally perhaps—discouraged employers from providing their workers with the professional advice that they need to plan for retirement. An abundance of facts underlines the need for the new safe harbor that Congress provided last year in the Pension Protection Act of 2006 (PPA). The average account balance in 401(k) plans increased 50 percent among participants who held accounts from 1999 to 2005, notwithstanding a major bear market in the middle of that period. The average account balance among this group in 2005 was $102,014. The bulk of these plan assets are invested in equities.[1] All of this is good news in addressing the savings crisis, of course, but the need for more than just plan sponsor-provided educational materials resulted in a congressional response to offer a prohibited transaction exemption for personalized advice through a new category of "fiduciary adviser," a milestone in pension reform that offers both opportunities and challenges in today's investment advice market.

Prudent Practices for Fiduciary Advisers is designed to address the needs of the newly designated fiduciary adviser in delivering custom advice to plan participants and their beneficiaries with regard to investment of their assets within an ERISA plan. Based on prudent practices developed by Fiduciary 360 for investment advisers registered under the Investment Advisers Act of 1940 and similar state statutes, these best practices are designed to reflect the need for more streamlined practices applicable to the mass market while maintaining appropriate fiduciary practices necessary for any investment advisory engagement—whether the account balance is $10,000 or $10 million.

Although investment advice has been provided to plan participants and beneficiaries in the past, the new safe harbor creates significant marketing opportunities for advisers in the insurance, banking, securities, and advisory industries, inasmuch as all can be fiduciary advisers under the new ERISA safe harbor, as long as they meet the requirements of the law. These best practices are intended to demonstrate to the fiduciary adviser how he or she may best adhere to ERISA requirements and satisfy the new exemption requirements of Sec. 601 of the PPA. In addition, it provides best practices for disclosure of other conflicts to clients when providing services outside of the ERISA advisory program. In summary, as the average age of America's workers lengthens, competent and ethical investment advice becomes even more critical to helping them reach their retirement objectives. The best practices contained in this handbook should help all parties comply with the spirit and letter of the new law, and to help the client better understand the fiduciary adviser's role in the sale of other financial products or services.

It should be noted that the investment fiduciary practices contained within this handbook have not been formally approved, disapproved, or otherwise acted upon by any volunteer committee of the Financial Planning Association and has no official or authoritative status. The FPA's participation is solely in the capacity of a technical reviewer and editor.

We gratefully acknowledge the invaluable contributions of the many CFP® practitioners and other experts who were instrumental in the review of the handbook. The FPA would like to acknowledge the special efforts of Stacy Schaus, CFP®, as chair of the task force that reviewed the best practices; Judy

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The Financial Planning Association (FPA®) is the membership organization for the financial planning community. Its 28,000 members are dedicated to supporting the financial planning process in order to help people achieve their goals and dreams. FPA believes that everyone needs objective advice to make smart financial decisions and that when seeking the advice of a financial planner, the planner should be a CFP professional. For more information about FPA, visit its Web site at www.fpanet.org.

Marvin W. Tuttle, Jr., CAE
CEO, Financial Planning Association
January 2007

Endnote

[1] Employee Benefit Research Institute, Issue Brief No. 296, August 2006.

PRACTICES, CRITERIA, SUGGESTED PROCEDURES, AND SUBSTANTIATION

This handbook defines prudent, or best, practices for the fiduciary adviser. The scope of the fiduciary adviser's *standard* is established by the *Prudent Practices* handbook, which is intended to provide the foundation and framework for a disciplined investment process and as part of a broader financial planning process.

Whenever an adviser is involved with ERISA rules, compliance can be even more complicated than under securities laws. One important tip: while reading through this handbook, please refer to the Glossary of Terms in Appendix C even for common terms, as well as those with which you may be unfamiliar. For example, "client" has a specific meaning in this handbook. Under ERISA, a financial planner may have different kinds of clients, including a participant, beneficiary, plan sponsor or other ERISA fiduciary. In this handbook, the term "client" always refers to the individual plan participant or beneficiary, not to the plan sponsor.

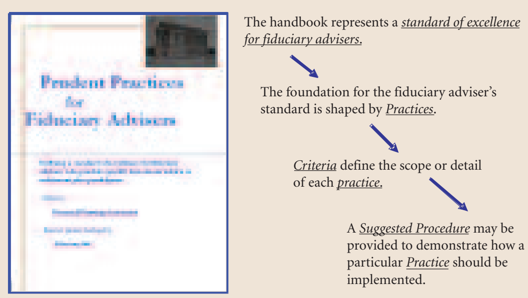
The practices are organized under a four-step investment management process. The steps are consistent with the global ISO 9000 Quality Management System standard, which emphasizes continual improvement to a decision-making process:

Step 1: Organize
(Practices that begin with FA-1.__)

Step 2: Formalize
(Practices that begin with FA-2.__)

Step 3: Implement
(Practices that begin with FA-3.__)

Step 4: Monitor
(Practices that begin with FA-4.__)



For each practice, one or more criteria are provided to establish the scope of the practice. In addition, a suggested procedure may be provided to demonstrate how the practice should be implemented.

The substantiation for each practice is also provided. All 19 practices are substantiated by legislation, case law, regulatory opinion letters, and/or industry-related codes of ethics from:

ERISA —Employee Retirement Income Security Act of 1974, as amended (regulates qualified retirement plans)

PPA—Pension Protection Act of 2006 (Title VI introduces the terms “fiduciary adviser,” “eligible investment expert,” and others)

CFP® Code of Ethics and Professional Responsibility (governs fiduciary advisers who hold the CFP certification)

Practice A-1.1

The fiduciary adviser demonstrates an awareness of the fiduciary duties and responsibilities required by ERISA, Section 601 of the Pension Protection Act of 2006 (PPA), and other applicable laws.

CRITERIA

1.1.1 The fiduciary practices and procedures in this handbook are applied.

Discussion

A fiduciary is generally defined as someone acting in a position of trust on behalf of, or for the benefit of, a third party. Fiduciary status is sometimes difficult to determine under financial services laws, but not in the case of "fiduciary advisers" in the PPA. The term "fiduciary adviser" is defined as a person who is a fiduciary of a plan by reason of the provision of investment advice to a plan participant or beneficiary with respect to plan assets for a fee or other compensation. With respect to regulatory status, they must be affiliated with a trust department of a bank or similar depository institution, an insurance company, a broker-dealer, a registered investment adviser, or an agent or affiliate of one of these firms. Since fiduciary advisers are required to acknowledge their fiduciary status under ERISA to the plan and its participants, a fiduciary adviser must adhere to the same broad fiduciary duties of other ERISA fiduciaries. However, ERISA fiduciary status is limited to the actual duties assumed over the investment of plan assets. Section 601 fiduciary status requires the fiduciary adviser to assume fiduciary duties only in providing investment advice to the client. The investment advice to plan participants and their beneficiaries under Section 601 is limited to the investment options which have been selected by the plan sponsor or other ERISA fiduciary (who may or may not be affiliated with the fiduciary adviser). The clients are required under Section 601 to direct the investments of the assets in their accounts among the investment options available under the plan. It is *not* the responsibility of the fiduciary adviser to assume investment discretion over the client's account, but rather to provide investment advice to participants and beneficiaries so that they may make smart and disciplined long-term investment decisions on their own.

Until the U.S. Department of Labor issues guidance and finalizes regulations under the PPA, including requirements under Section 601 for fiduciary advisers, the fiduciary adviser's role should be assumed to be that of other legal fiduciaries with duties of care and loyalty to the client. Further, it should be assumed that the fiduciary adviser is subject to the ERISA prudent man standard of care, that is, the fiduciary adviser will discharge his or her duties with the care, skill, prudence, and diligence then prevailing that a prudent man acting in a like capacity and familiar with such matters would use.

The principal area of interest for plan sponsors in this handbook is the introduction of a new "safe harbor" in the PPA for plan fiduciaries who want to provide participants and beneficiaries with self-directed accounts the opportunity to receive specific investment advice. The PPA provides that plan sponsors or other ERISA fiduciaries will not be liable for the actual advice given by the fiduciary adviser if they delegate the personalized investment advisory activities to a qualified investment professional and require the fiduciary adviser to adhere to the requirements of the Section 601 of the PPA.

Likewise, financial planners and other investment professionals providing personalized advice to participants and beneficiaries will receive a safe harbor from ERISA's prohibited transactions rules. In order to receive the benefits of this safe harbor, the fiduciary adviser who provides advice to the plan participant or beneficiary, referred to as the "client" in the handbook, must comply with the requirements of an "eligible investment advice arrangement," or advice program, as detailed in the Act. (See Glossary of Terms in Appendix C for definitions.) The basic requirements (discussed in greater detail throughout the *Prudent Practices*) are to disclose conflicts of interest to the client, including sources of all fees and compensation related to the plan and its investment options that are received by the fiduciary adviser.

If a fiduciary adviser or its affiliates receives fees or other compensation that varies depending upon the investment options selected by the client, then the employer would contract with a fiduciary adviser to provide advice using a certified computer model. The purpose is to eliminate the financial incentives or potential conflicts of interest the fiduciary adviser has in recommending investments that could increase his or her compensation. The computer model must be certified (prior to being used) by an independent eligible investment expert that the computer program meets the requirements as established by the U.S. Department of Labor. If there are modifications to the software program, it must be re-certified.

As an alternative, if the fiduciary adviser's fees do not vary, then the fiduciary adviser may provide personalized advice outside the advice generated by the computer model that participants and beneficiaries can use to develop asset allocations for their retirement accounts.

In either situation, an annual independent audit must be conducted by an auditor with appropriate training, experience, and proficiency to ensure compliance with Section 601 of the Act. Section 601 requires an independent auditor to attest in writing to the plan sponsor or other fiduciary compliance by the fiduciary adviser with all the requirements of the exemption.

Please note that the prudent practices in this handbook are useful not only for a fiduciary adviser who enters into an eligible investment advice arrangement in conformance with the PPA, but also for other fiduciaries who provide individualized investment advice to participants and beneficiaries with respect to their self-directed retirement accounts. However, most of the comments in this handbook reflect investment advice provided by fiduciary advisers under Section 601 of the PPA. Fiduciary advisers also need to be aware of all the requirements in Section 601 related to the delivery of personalized investment advice to plan participants and beneficiaries.

Practice A-1.1

The fiduciary adviser demonstrates an awareness of the fiduciary duties and responsibilities required by ERISA, Section 601 of the Pension Protection Act of 2006 (PPA), and other applicable laws.

Furthermore, a fiduciary adviser who contemplates adherence to these best practices should evaluate his/her ability to do so if the plan sponsor intends to rely primarily on a certified computer advice program in providing advice to plan participants. For example, if the fiduciary adviser's role in the advice program is limited to explaining how the asset allocations generated by the computer model fit into the client's overall retirement objectives, then it may be impractical for the fiduciary adviser to comply with the best practices as enumerated in this handbook. At a minimum, such limitations should be clearly explained to the client and disclosed in the client engagement letter.

Suggested Procedure

It is important to carefully review Section 601 of the Act to understand the various compliance requirements of a fiduciary adviser and to review all relevant rules and regulations to be promulgated by the Department of Labor. The PPA also requires that a fiduciary adviser provide appropriate disclosure, in connection with the sale, acquisition, and holding of the security or other property in compliance with applicable securities laws, which would include disclosure and recordkeeping requirements of the Investment Advisers Act of 1940 and comparable state laws, as well as disclosure and suitability requirements for broker-dealers under NASD rules. In contrast, Section 601 does not refer to insurance or banking laws for additional disclosure requirements. Therefore, those fiduciary advisers who are acting in the capacity as registered representatives of a broker-dealer or investment adviser representatives of an SEC or state-registered investment adviser may have additional disclosure requirements beyond those required under the Act.

For example, registered representatives who receive a fee for their advice may be required to provide the necessary disclosure as required by Rule 202(a)(11)-1 (known as "Rule 202") of the Investment Advisers Act of 1940 (Advisers Act) for providing fee-based "brokerage" services to the client.

Investment adviser representatives should provide clients a copy of Form ADV Part II and any other necessary disclosures and advertising rules, such as compliance with the Cash Solicitation Rule if they pay a referral fee to act as a fiduciary adviser. In addition, investment adviser representatives should avoid the use of client testimonials in marketing materials. They should also modify their existing Form ADV, as necessary, to reflect changes in their business model, such as minimum net worth requirements.

In addition, because the best practices are designed to address compliance requirements of a CFP practitioner, rules from the *CFP Code of Ethics and Professional Responsibility* are also referenced throughout the handbook.

Substantiation

Employee Retirement Income Security Act of 1974 [ERISA]

Sections 408(b)(14) and 408(g)

Pension Protection Act of 2006 [PPA] § 601(a)(1)and(2)

Investment Advisers Act of 1940

§ 275.202(a)(11)-1 (Broker-Dealer Rule)

§ 275.204-3 (Brochure Rule)

§ 275.206-(4)-3 (Cash Solicitation Rule)

CFP Code of Ethics and Professional Responsibility

Rules 201, 202, 301, 302, 401–405, 501, 606, 608, 701–704

NASD Rules

NASD Conduct Rule 2310 ('Know Your Customer' and related rules)

Practice A-1.2

Investment advice provided to the client is in accordance with applicable laws, trust documents, and written investment policy statements (IPS).

Discussion

The starting point for the fiduciary adviser is to review all of the agreements related to the eligible investment advice arrangement, as well as personal client data relevant to management of the client relationship. This may include an investment policy statement adopted for the plan as a whole by the plan sponsor or other fiduciary and/or agreements between the fiduciary adviser and the plan sponsor or other plan fiduciary, as well as with the client. The PPA requires that there be a written agreement between the fiduciary adviser and the plan sponsor or other fiduciary which sets forth the terms and conditions of the eligible investment advice arrangement and requires the fiduciary adviser to comply with the requirements of Section 601 of the PPA. As with the management of any business decision, the financial adviser should set definitive goals and objectives with the participant and beneficiary that are consistent with the scope of the engagement.

Proof that such a framework has been established presumes written documentation exists at least in the form of an agreement with the plan sponsor or other fiduciary and the fiduciary adviser and an investment policy statement developed for the client.

Suggested Procedure

The following documents should be collected, reviewed, analyzed, and kept on file for each client:

☐ A copy of the agreement between the fiduciary adviser and the individual client.

☐ A copy of the client's investment policy statement (IPS).[1]

☐ A copy of any agreements related to the eligible investment advice arrangement, including the engagement agreement between the plan sponsor or other fiduciary and the fiduciary adviser.

☐ A copy of any disclosure documents required by the U.S. Department of Labor related to the eligible investment advice arrangement.

☐ Information on any qualified default investment alternative offered under the plan.

☐ If affiliated with a registered investment adviser, a copy of a signed and dated document that the client has received a current copy of Form ADV Part II, as well as a copy of the annual notice and offer to the client.

☐ A copy of the current Form ADV Part II provided to clients.

☐ If a registered representative of a broker-dealer, a copy of the notice required under Rule 202(a)(11)-1 of the Advisers Act, if applicable.

CRITERIA

1.2.1 Investment advice is provided in accordance with ERISA, Section 601 of the Act, and other applicable laws.

1.2.2 Investment advice is provided in accordance with the client agreement.

1.2.3 Investment advice is provided in accordance with client's written IPS.

1.2.4 Client documents related to the eligible investment advice arrangement are stored in a centralized location and maintained for at least six years.

☐ A copy of the current prospectus for each mutual fund or other investment option that is offered in the plan.

☐ A copy of the current prospectus for any company stock that is offered by the plan sponsor as an investment option or contribution to the plan.

☐ Any investment performance reports and other materials provided to plan participants and beneficiaries by the plan sponsor, or other fiduciary, or registered investment company that are also shared with the fiduciary adviser.

☐ Maintenance and secure storage of all client records for a minimum of six years.

Note: The PPA allows electronic delivery of documents to the client, although the generally applicable regulations promulgated by the Department of Labor relating to general disclosure requirements under ERISA have not yet been updated to include the disclosure requirements under the PPA.

Substantiation

Employee Retirement Income Security Act of 1974 [ERISA]

Sections 404(a)–(c), 408(b)(14) and 408(g)(6)–(9) and (10)(A); 29 C.F.R.

2520.104b-1-(c) (disclosure through electronic media).

Pension Protection Act of 2006 [PPA] § 601(a)(1) and (2).

Investment Advisers Act of 1940

§ 275.202(a)(11)-1 (Broker-Dealer Rule)

§ 275.204-2 (Books and Records Rule)

§ 275.204-3 (Brochure Rule)

CFP Code of Ethics and Professional Responsibility

Rules 202, 401–405, 501, 606, 608

Practice A-1.3

The roles and responsibilities of plan sponsor, the fiduciary adviser, and client are defined, documented, and acknowledged.

Criteria

1.3.1 The fiduciary adviser and plan sponsor discuss their respective duties and acknowledge their responsibilities in a written agreement.

1.3.2 The fiduciary adviser and client discuss their respective duties and acknowledge their responsibilities in the written advisory agreement.

1.3.3 The respective roles and responsibilities of the fiduciary adviser and client are discussed and documented in the IPS.

Discussion

There are numerous parties involved directly or indirectly in an eligible investment advice arrangement. The fiduciary adviser should be aware of all of the parties involved and their roles and responsibilities in connection with a qualified plan. In addition to the fiduciary adviser, these may include

- the plan sponsor, or company, that offers the qualified plan to its employees
- an investment manager or other fiduciary who selects and manages the investment options
- a record keeper (who prints statements, maintains records of plan assets and contributions of the company and the employee, records participant asset allocation changes, and provides general administrative support for the plan)
- a third-party administrator (who acts on behalf of the plan sponsor to administer the plan, including compliance, testing, and reporting)
- a trustee (either discretionary or directed) and/or custodian (who maintains control and/or custody of the plan assets and performs some recordkeeping and reporting activities)
- an independent auditor
- eligible investment expert

With the exception of the plan sponsor, independent auditor, and eligible investment expert, some or all of the above functions may be "bundled" by one entity that provides all of the administrative, investment advisory, and custody services on behalf of the plan sponsor. It is anticipated that an eligible investment advice arrangement, or "advice program," may also be offered as part of a bundled package of services. In the context of an advice program, the best practices in this handbook apply to an investment adviser providing advice, not to the advice generated by a computer program.

The investment policy statement (IPS) plays a critical role in the client relationship. The specific duties and requirements of the fiduciary adviser to the client should be documented in the client's IPS. [See Practice A-2.6.] This ensures continuity of the investment strategy when there is a change in fiduciary advisers, to avoid misunderstandings with the client, and to prevent omission of critical fiduciary functions.

The IPS should include sections on:

- An overview of the client's financial circumstances, including objectives, assets, and other retirement benefits
- The client's risk tolerance, investment preferences, and time horizon

- Acceptable asset classes and investment vehicles
- Criteria for selection of investments
- The implementation and monitoring responsibilities of the client
- Investment monitoring and control procedures of the fiduciary adviser
- Reporting practices

Substantiation

Employee Retirement Income Security Act of 1974 [ERISA]

Sections 404(a)–(c), 408(b)(14), and 408(g).

Pension Protection Act of 2006 [PPA] §601(a)(1) and (2).

Investment Advisers Act of 1940

§ 275.204-2 (Books and Records Rule)

CFP Code of Ethics and Professional Responsibility

Rules 201, 202, 701–704

Practice A-1.4

The fiduciary adviser complies with the eligible investment advice arrangement and related requirements of the Section 601 safe harbor.

Criteria

1.4.1 Disclosures shall be prominent and easily understood by the client.

1.4.2 All disclosures shall conform to Department of Labor rules, applicable securities laws, and code of ethics requirements of the fiduciary adviser.

1.4.3 Compensation paid to the fiduciary adviser shall be reasonable and fully disclosed to the client.

1.4.4 Designated senior staff of the fiduciary adviser's firm is assigned the responsibility of overseeing and managing potential conflicts of interest.

1.4.5 The fiduciary adviser annually acknowledges to the client compliance with these best practices in writing.

Discussion

The fundamental duty of the fiduciary adviser is to provide investment advice for the exclusive benefit of the client. Section 601 of the Act provides that the fiduciary adviser disclose information to the client about potential conflicts to the client. Yet the fiduciary adviser should consider other disclosures beyond those required by law.

A question fiduciary advisers must ask themselves before making an investment recommendation is: Who benefits most from the decision? If the answer is any party other than the client, there is a likelihood of a conflict and potential breach of fiduciary duty. If a fiduciary adviser believes that he or she may have a conflict of interest—he or she should review the issue with designated senior staff of their firm. Such senior staff should have knowledge of ERISA and other applicable laws, such as the Investment Advisers Act of 1940. If a real or potential conflict exists, the best practice, of course, is to discontinue the activity that raises a conflict, disclose it if permitted as a remedy by rule or statute, or avoid the potential conflict in the first place.

The fiduciary adviser should have defined policies and procedures which govern the investigation and management of potential conflicts of interests.

Suggested Procedure

Disclosure Standards. The PPA adds ERISA Section 408(g)(8) which requires disclosure of information provided to clients to be written in a "clear and conspicuous manner…calculated to be understood by the average plan participant."

The disclosures must be sufficiently "accurate" and "comprehensive." The Department of Labor is required under the Act to issue a model form for disclosure of fees and other compensation received by the fiduciary adviser and its affiliates.

Required Disclosure Items. As required by law, the fiduciary adviser must disclose:

- The role of any party that has a material or contractual relationship with the fiduciary adviser in the development of the investment advice program and the selection of the investment options used in the plan.
- Past performance and historical rates of return of the investment options in the plan.
- All fees or other compensation relating to the advice of the fiduciary adviser (including fees received in connection with the sale, acquisition, or holding or a security or other property in connection with the participant's investment decisions), or that any affiliate will receive (including fees or other compensation provided by third parties). A specific model form will be developed by the Department of Labor in the near future for this purpose.
- Any material affiliation or contractual relationship of the fiduciary adviser or affiliates in the security or other property (such as proprietary mutual funds).

- The manner and circumstances in which client information will be used or disclosed.
- The types of services provided by the fiduciary adviser in connection with the investment advice.
- That the fiduciary adviser is acting as a fiduciary in providing the investment advice.
- That the recipient of the advice may use another adviser who is not affiliated with and who receives no fees in connection with the security or other property offered under the plan.

For Registered Representatives of NASD member firms (if receiving fee-based compensation):

- Copy of disclosure required by Rule 202 of the Advisers Act.

For Investment Adviser Representatives:

- Form ADV Part II.

For CFP Certificants:

- Business affiliation, name, address, telephone number, credentials, qualifications, licenses, compensation structure, and scope of the certificant's authority (if not contained in Form ADV Part II).
- A written statement that the client has the right to ask at any time for information about the compensation of the CFP certificant (if the eligible investment advice arrangement is part of a financial planning engagement).

Compensation. The fiduciary adviser's compensation must be

- Reasonable.
- "Level," that is, does not vary depending on the basis of any investment recommendation by the fiduciary adviser, if advice is not based on a computer model. Note: the fiduciary adviser's compensation may vary if the client relies on advice from a certified computer program.

Compensation can be a salary, fee, commission, or other things of monetary value, as long as it meets the above requirements.

Substantiation

Employee Retirement Income Security Act of 1974 [ERISA]

Sections 404(a)–(c), 408 (b)(2)and (14), (g) (6)–(8); 29 C.F.R. 2550.408b-2 (c) and (d).

Pension Protection Act of 2006 [PPA] §601(a)(1) and (2).

Investment Advisers Act of 1940

§ 275.202(a)(11)-1 (Broker-Dealer Rule)

§ 275.204-2 (Books and Records Rule)

§ 275.204-3 (Brochure Rule)

CFP Code of Ethics and Professional Responsibility

Rules 202, 401–405, 606, 608

THE ELIGIBLE INVESTMENT ADVICE ARRANGEMENT BETWEEN THE FIDUCIARY ADVISER AND THE PLAN SPONSOR OR OTHER RELEVANT PLAN FIDUCIARY SHALL CONFORM TO THE GENERAL FIDUCIARY STANDARDS OF LOYALTY AND CARE UNDER ERISA, SECTION 601 OF THE ACT, AND OTHER APPLICABLE LAWS.

Discussion

In addition to compliance with the statutory requirements and rules promulgated under the Act, the fiduciary adviser should adhere to certain ethical standards as a best practice. As a fundamental tenet of all fiduciary practices and as a basic way of doing business, all obligations of the fiduciary adviser to the client should be documented in written contracts, the investment policy statement, and other important client communications. An example of an important communication might be securing written acknowledgement by the client of any intent to deviate from the fiduciary's recommended asset allocation, or to take a loan from the account, and acknowledging that such activities may affect the long-term modeled return for the portfolio.

Once the initial client meetings are over and recommendations have been made, the fiduciary adviser should also explain the steps that will be followed by both parties in implementing and monitoring the portfolio. These steps include reviewing relevant client agreements and the IPS at least once a year, and to request a meeting earlier should the client experience a life-changing event, such as leaving employment with the company, getting married or divorced, having children, receiving a significant inheritance, etc. Additionally, if the client holds a significant position in company stock (consistent with or contrary to the asset allocation model recommended by the fiduciary adviser), the fiduciary adviser should monitor the stock's performance and provide timely communications to the client if information is obtained of a material change in the outlook for that investment option.

Finally, the fiduciary adviser should have a compliance professional and/or legal counsel review the eligible investment advice arrangement and standard client agreements at least once a year to ensure compliance with all legal and regulatory requirements. Also, if the independent annual audit conducted for the plan sponsor or other fiduciary reveals any deficiencies in compliance with the requirements of the PPA, the fiduciary adviser shall initiate changes to correct and comply with law.

Substantiation

Employee Retirement Income Security Act of 1974 [ERISA] Sections 404(a)–(c) and 408 (b)(14) and (g)(5)–(9).

Pension Protection Act of 2006 [PPA], Section 601(a)(1) and(2).

Investment Advisers Act of 1940

§ 275.204-2 (Books and Records Rule)

CFP Code of Ethics and Professional Responsibility

Rules 202, 606, 701

Case Law

SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963)

CRITERIA

1.5.1 Eligible investment advice arrangements with the appropriate plan fiduciary and individual client agreements are in writing.

1.5.2 The fiduciary adviser and client review the client agreement and IPS at least annually to ensure consistency with the needs of the client.

1.5.3 Amendments to eligible investment advice arrangements and client agreements are reviewed at least annually by the fiduciary adviser's legal counsel.

1.5.4 Any independent audit which reveals deficiencies in fiduciary adviser's compliance with the requirements of Section 601 of the PPA shall be remedied in a timely fashion to conform with the law.

Practice A-1.6

The fiduciary adviser shall advise the client regarding asset protection concerns related to potential theft, embezzlement, and civil litigation.

Criteria

1.6.1 The fiduciary adviser shall discuss with the client which assets are generally protected from creditors and which are not.

1.6.2 The fiduciary adviser shall comply with any required surety bond.[2]

1.6.3 The fiduciary adviser shall ensure privacy of the client information received in the course of the engagement and shall notify the client in writing as required by the PPA of the uses and disclosures of client information.

Discussion

Qualified plan assets under ERISA and individual retirement accounts, similar to a primary home, are protected from liability claims filed in court or from creditors when a bankruptcy application is filed. In addition, if the fiduciary adviser becomes aware of a change in the client's marital status, he or she should advise the client of the need to consider changes to beneficiaries or to the possible division of retirement assets in a divorce settlement. If the fiduciary adviser identifies any potential threat to the client's account by theft of privacy information or embezzlement, he or she should make the client aware of these concerns. In turn, the fiduciary adviser has a duty under financial services laws to ensure the privacy of client information maintained by the fiduciary adviser. Section 601(b) of the PPA adds ERISA Section 408(g)(6)(v), which requires the fiduciary adviser to notify the client regarding "the manner, and under what circumstances, any participant or beneficiary information provided under the arrangement will be used or disclosed."

The fiduciary adviser should decline any requests by the client to handle administrative work related to the account or manage changes to investment allocations even if the client offers to give the fiduciary adviser usernames and passwords. Such actions would, at a minimum, trigger custody rule requirements under the Advisers Act or equivalent state laws, unless the fiduciary adviser's firm has custody of plan assets or other accounts of the client, and is in compliance with such rules.

Finally, the fiduciary adviser should be aware of any bond requirements under ERISA, and whether any existing bonds may cover the eligible investment advice arrangement. For example, a state-registered investment adviser should determine whether an existing bond required by a state securities administrator also may satisfy an ERISA bonding requirement. Broker-dealers are permitted specifically under the PPA to satisfy bonding requirements with custodial bonds already required under NASD rules.

Suggested Procedure

The following check list should be reviewed by the fiduciary adviser:

☐ Marital status of the client

☐ Names and relationships of the primary and secondary beneficiaries of the client

☐ Any potential problems the client may be aware of regarding privacy issues, including usernames and passwords

☐ A determination, prior to implementation of an advice program, that the fiduciary adviser maintains a surety bond in the amount required under ERISA

☐ A written disclosure regarding the manner and circumstances in which client information obtained in the provision of investment advice will be used or disclosed

Substantiation

Employee Retirement Income Security Act of 1974 [ERISA]

Sections 403(c), 404(a)–(c), 405 (a), 408(g)(6)(A)(v) and 412.

Pension Protection Act of 2006 [PPA] Section 601(a) (1) and (2).

CFP Code of Ethics and Professional Responsibility

Rules 501, 606, 701

Practice A-1.7

In the event the client should request services unrelated to the eligible investment advice arrangement, the fiduciary adviser shall provide appropriate written disclosure of any material conflicts of interest.

Criteria

1.7.1 The fiduciary adviser will first determine whether the relationship is warranted, based on the client's needs and objectives.

1.7.2 The fiduciary adviser has the requisite competency to provide those services or involve or refer them to other appropriate professionals for assistance.

1.7.3 If the fiduciary adviser provides other advisory services to the client, he or she will disclose and document any change in fiduciary status prior to providing such services.

Discussion

The PPA requires the fiduciary adviser to state the obvious: that he or she will act in a fiduciary capacity to the client. The Act does not, however, require disclosure of any change in fiduciary status outside of the eligible investment advice arrangement, unlike the implicit requirement under the Adviser Act for investment advisers who "change hats" and disclose a change in regulatory standards when acting in a different capacity, that is, as a registered representative or insurance agent.

As a best practice, the fiduciary adviser should disclose when he or she will no longer act in the client's best interest, that is, as a fiduciary, prior to providing any services separate from the eligible investment advice arrangement. For example, if the fiduciary adviser's primary affiliation is with an insurance company or broker-dealer, whose laws do not have a similar fiduciary requirement, the fiduciary adviser should disclose in writing the change in regulatory status and that the obligations of the adviser to the client may change in providing other services outside of the qualified plan.

Suggested Procedure

If the fiduciary adviser deems such services are warranted and a professional referral is not needed, he or she should disclose to the client, prior to undertaking the new engagement, the following information if no longer acting in a fiduciary capacity in providing additional services:

☐ Written or electronic disclosure stating prominently in plain English that the fiduciary adviser will no longer have a fiduciary responsibility to the client with respect to the additional services, listing the relevant business affiliations of the adviser, and describing how these may create potential conflicts of interest.

☐ In addition to delivering an electronic or written disclosure document to the client, the fiduciary adviser should also discuss with the client the differences in his or her role and responsibilities in providing services separate from the advice program.

☐ Registered investment advisers will have already satisfied this requirement at the onset of the eligible investment advice arrangement if they provided the client with a copy of Form ADV Part II.

☐ Registered representatives of a broker-dealer should provide the so-called Rule 202 disclosure document that would be provided to brokerage clients of the Advisers Act, should fee-based advisory services be offered outside of the eligible investment advice arrangement.

Substantiation

Employee Retirement Income Security Act of 1974 [ERISA]

Sections 404(a)–(c).

Pension Protection Act of 2006 [PPA] , Section 601(a)(2).

Investment Advisers Act of 1940

§ 275.202(a)(11)-1 (Broker-Dealer Rule)

§ 275.204-3 (Brochure Rule)

CFP Code of Ethics and Professional Responsibility

Rules 202, 302, 401–404, 702

Endnotes

[1] Unless otherwise noted, the handbook refers to the client's IPS, not an IPS for the plan's investment objectives.

[2] Note: The PPA is unclear on whether an independent fiduciary adviser, acting solely in the capacity of providing advice to participants, and not managing ERISA assets, is required to be bonded under ERISA. Generally, however, an ERISA fiduciary who exercises control over, or has access to, plan assets, is required to be bonded. Guidance from the Department of Labor may be necessary to clarify these bonding requirements.

Practice A-2.1

Investment options are analyzed by the fiduciary adviser and reviewed with the client.

Criteria

2.1.1 The fiduciary adviser is conversant with the investment options available under the eligible investment advice arrangement.

2.1.2 Investment options within the plan are mutually reviewed and discussed with the client.

2.1.3 Decisions regarding passive and active investment strategies, as well as the risks of market timing, are discussed with the client and documented.

2.1.4 If the employer has automatically enrolled the client in a qualified plan, a decision regarding the continued use of a qualified default investment alternative (such as a life cycle fund) is discussed with the client.

2.1.5 If employer stock is offered under the plan as an investment option, a decision regarding the investment in the employer stock option shall be discussed with the client.

Discussion

The primary focus of this Practice is the analysis of the investment options that are available within the qualified plan, and communicating the qualitative factors to the client.

An ERISA plan could have as few as three or a practically unlimited set of investment options available to the client. It is important that the fiduciary adviser become knowledgeable with the available investment options in the plan, since the risk and return for an asset allocation can vary considerably, particularly when the alternatives are limited.

The fiduciary adviser also should be able to demonstrate that he or she discussed the various options with the client, and advised them to implement, when appropriate, passive asset allocation strategies. In connection with passive investment strategies, the fiduciary adviser should also discuss classic problems with market timing strategies and "chasing performance."

The fiduciary adviser should also discuss with the client the advantages and disadvantages of investing in an employer stock fund if available as an investment option under the plan.

In addition, the fiduciary adviser should discuss the advantages and disadvantages of continued participation in a qualified default investment alternative (QDIA), if the client is currently enrolled.

Some of the factors to be considered in reviewing the plan's investment options:

- Amount of client portfolio exposure to company stock
- The degree to which each investment option is diversified
- Ease in the client's ability to manage asset allocation and rebalancing
- Cost of plan fees and investment expenses

In other words, a fiduciary adviser has a duty to ensure that the client is aware of the long-term effect of plan fees and investment expenses on portfolio returns, and in considering the impact of certain investment options on the client's investment objectives. To the extent that the fiduciary adviser believes the overall investment options in a plan are substandard in terms of expenses and investment options when compared to similar-sized plans, the fiduciary adviser should discuss these concerns with the client.

[Note: While not incorporated as a best practice in this handbook, inasmuch as the practices address investment advice to the plan participant, the fiduciary adviser may personally believe he or she has an additional obligation to raise these issues with the plan sponsor. The independent financial planner in particular, who is otherwise not involved in selecting the plan's investment options, may reduce his or her own potential liability by encouraging the plan sponsor (and documenting such communications) to meet desired safe harbor requirements.]

Suggested Procedure

One of the challenges the fiduciary adviser may face with a small portfolio (the vast majority of 410(k) accounts average less than $50,000) is being particularly sensitive to plan costs and investment expenses associated with each option. The adviser's analysis with respect to mutual fund, separately managed, and closed investment trust options should include:

(1) Total return

(2) Risk measures

(3) Portfolio "drift"

(4) Overweighting of a particular stock in a client's portfolio

(5) Fees and expenses for each option

(6) The general availability of diversified assets in the plan: bonds, cash, small and large cap funds, international, and REITs

(7) Turnover rate of stocks in each option

(8) Experience of the portfolio manager or investment team

(9) Corporate governance within the fund family

Substantiation

Employee Retirement Income Security Act of 1974 [ERISA]

Sections 204(j) ,404(a)–(c), 405(a), 408(b)(14) and 408(g) (6)–(8).

2006 Pension Protection Act [PPA] Sections 901(b), 624 (a) and 601(a)(1) and (2).

CFP Code of Ethics and Professional Responsibility

Rules 202, 701, 703, 704

NASD Rules

NASD Conduct Rule 2310 ("Know Your Customer" Rule)

Practice A-2.2

An investment time horizon has been identified and documented for the client.

Criteria

2.2.1 If the scope of engagement precludes an assessment of the client's other assets and liabilities, the fiduciary adviser shall notify the client in writing of limitations regarding suitability of the advice and the modeled portfolio return.

2.2.2 Sources, timing, distribution, and uses of the client's current and future projected cash flows from the portfolio are discussed with the client.

2.2.3 Sufficient liquid assets for contingency plans have been identified and discussed with the client.

2.2.4 If the investment time horizon has not been clearly defined by the client, the default standard should be actuarial data for life expectancy of a person that age.

Discussion

Prior to discussing the investment recommendations, the fiduciary adviser should make the client aware of any limitations in the scope of advisory services being provided. In other words, if the scope of services provided in the eligible investment advice arrangement does not include detailed analysis of other client assets (a taxable investment portfolio, IRAs, real estate, etc.), it is critical that the fiduciary adviser make the client aware of this important limitation in writing.

Nonetheless, while the fiduciary adviser may not develop a comprehensive retirement plan for the client, it is still necessary that he or she understand the client's current income needs before discussing with the client recommendations on how much should be deferred from salary by the client and contributed to the qualified plan on a regular basis. Just as one of the initial activities of a financial planner is to inquire about the client's ability to pay current bills and liabilities when assessing a client's retirement planning needs, so should a fiduciary adviser follow the same premise. A simplified IPS included on page 52 of the handbook illustrates the basic data that should be reviewed by the fiduciary adviser in developing investment recommendations.

In contrast to other clients of a fiduciary adviser, the clients in an eligible investment advice arrangement may have few or no assets saved for retirement. As a result, some of the detailed criteria required for high net-worth clients may be simplified due to the limited scope of engagement, or in the event a plan participant is young and just beginning to save for retirement.

One of the most important processes the fiduciary adviser has to manage, no matter the client's preparations for retirement or size of the portfolio, is their investment time horizon. For purposes of the best practices in this handbook, the time horizon can be defined simply as the accumulation phase of the retirement plan, that is, how much money flows into the portfolio until the point in time when the client anticipates to retire.

Based on the time horizon, the current size of the client's portfolio, and the constraints of the investment options available in the qualified plan, the fiduciary adviser then can determine which asset classes should be considered; what the allocation should be between selected asset classes; whether there should be an allocation made among sub-asset classes (if such investment options are available); and, finally, which mutual funds should be selected for each asset class.

Suggested Procedure

Based on the client's time horizon, the fiduciary adviser should determine, in order:

1. Any significant position in company stock, and whether this holding should be cut back to reduce portfolio volatility and to optimize the modeled rate of return

2. Which asset classes should be considered

3. What the allocations should be between the selected asset classes

4. If the plan offers the choice of various investment options, which is best suited for the client

The fiduciary adviser should also assess the client's current cash flow to determine if the client should delay making salary deferrals to a qualified plan in order to first pay off credit card debt or other liabilities.

Substantiation

Employee Retirement Income Security Act of 1974 [ERISA]

Sections 204(j) and 404(a)–(c).

Pension Protection Act of 2006 [PPA}, Sections 601(a)(1) and (2) and 901(b).

CFP Code of Ethics and Professional Responsibility

Rules 202, 701, 703

NASD Rules

NASD Conduct Rule 2310 ("Know Your Customer" Rule)

Practice A-2.3

A risk level has been identified for the client.

Criteria

2.3.1 The level of risk in the client's portfolio is explained, and the quantitative and qualitative factors that were considered are discussed and documented.

2.3.2 If the client is within five years of retirement, his or her liquidity needs and investment risk have been anticipated in determining that the portfolio is projected to have sufficient retirement income to meet long-term needs.

Discussion

The term "risk" has different connotations, depending on the fiduciary adviser's or client's frame of reference, circumstances, and objectives. Typically, the investment industry defines risk in terms of statistical measures such as standard deviation. However, these statistical measures may fail to adequately communicate the potential negative consequences an investment strategy can have on the client's ability to meet investment objectives.

Simply stated, an investment strategy can fail by being too conservative or too aggressive. A fiduciary adviser could adopt a safe investment strategy by keeping a portfolio in cash, but then see the portfolio's purchasing power erode through inflation. Or a long-term growth strategy could be implemented that overexposes a portfolio to equities, when a more conservative fixed-income strategy would be sufficient to cover the identified goals and objectives if the client is approaching retirement with sufficient assets.

Suggested Procedure

One suggested approach is to "stress test" a client's proposed investment strategy by analyzing possible outcomes (worst case, most likely, and best case) over the accumulation phase. The fiduciary adviser should then consider the possible consequences of each outcome:

1. Will the investment results enable the client to cover short- and long-term liabilities and meet the client's retirement objectives?
2. Can the client stomach the worst-case scenario? If not, the client will likely abandon a sound, long-term strategy during a market downturn, altering the investment strategy at precisely the wrong time and for the wrong reasons.
3. If the client's risk tolerance level is too low, that is, the client is unlikely to achieve the modeled portfolio's rate of return absent a more aggressive investment strategy, the fiduciary adviser should suggest other alternatives to consider, such as delaying the expected year of retirement, working part-time in retirement, or some alternative to meet the retirement objective.
4. If the client is within five years of retirement and on track to meet his or her investment objectives, the fiduciary adviser should encourage the client to start to think in terms of a different asset mix that preserves assets during the draw down phase of retirement.

Substantiation

Employee Retirement Income Security Act of 1974 [ERISA]

Sections 204 (j) and 404(a)–(c).

Pension Protection Act of 2006 [PPA] Sections 601(a)(1) and (2) and 901(b).

CFP Code of Ethics and Professional Responsibility
Rules 202, 701, 703

NASD Rules

NASD Conduct Rule 2310 (“Know Your Customer” and related rules)

Practice A-2.4

An expected, modeled return to meet the investment objectives of the client in the eligible investment advice arrangement has been identified and documented.

Criteria

2.4.1 The "expected" or "modeled" return and volatility of the portfolio is consistent with the client's investment goals and objectives.

2.4.2 The expected or modeled return, volatility and correlation assumptions for each asset class are derived from long-term return patterns and the current economic outlook, as opposed to recent short-term performance.

Discussion

The fiduciary adviser should determine whether the client's current asset allocation meets a minimal investment return expectation or requirement for purposes of the advice program. In instances where the advice program utilizes a certified computer program for developing the asset allocations, the fiduciary adviser's task may be focused more on gathering client data and determining the suitability of the modeled asset allocations to the client's personal investment objectives. In the absence of a certified computer program, the fiduciary adviser should determine what the "modeled," or expected return of a given investment strategy is likely to produce, and whether it meets the client's stated investment goals and objectives for retirement.

In the latter context, the term "model" means to replicate the probable returns and risks of an investment strategy given current and historic information. There is no fiduciary requirement or expectation that the fiduciary adviser is capable of forecasting future returns. Rather, the fiduciary adviser is required to demonstrate that an appropriate process was followed in developing the assumptions used to model the probable outcomes of a range of investment strategies.

Suggested Procedure

An optimizer requires three inputs:

Expected Return—the *modeled* return assumption that will be used for each asset class.

Standard Deviation—the *probable* level of variability each asset class will exhibit.

Correlation Coefficient—the *estimate* of the degree to which each asset class will perform relative to another. (Traditionally, equities and fixed-income asset returns have not been similar over the same periods of time; therefore, these asset classes would have a low correlation to one another.)

Note that all three optimizer variables are nothing more than estimates, models, or probable outcomes. The asset allocation strategy must be built upon carefully developed expectations for the capital markets and the way in which individual asset classes are expected to perform in relation to, and in combination with, each other. The fiduciary adviser may be constrained in developing portfolio optimization due to a limited number of investment options in the qualified plan or because these algorithms are calculated by the certified computer model.

The development of sound optimizer criteria involves as much art and intuition as science, and is well beyond the intended scope of this handbook. However, the fiduciary adviser should be familiar with the source and methodology used to develop any asset allocation strategy. Due to the great disparity between different models available to independent fiduciary advisers, careful research into the investment expertise of the source is required. The fiduciary adviser also should be prepared to discuss any differences in any investment recommendations of the certified computer program approved by the plan and the fiduciary adviser's own investment recommendations.

Along these same lines, the modeling of a probable return for a given asset allocation strategy is very difficult to develop. Simple extrapolations of recent historical data, particularly those of simple retirement planning calculators, not only are likely to be poor estimates of future performance, the results also may raise questions regarding the fiduciary adviser's calculations. Such differences might include computer calculations that overweight an asset class that has had recent superior performance and underweighting the laggards, thus setting the stage for a classic investment mistake of chasing recent investment performance.

Again, the fiduciary adviser should be wary of an optimizer that derives inputs only from historical data. Most investment professionals use a "risk-premium" model. Developing the risk premium is quite involved but, simply stated, the process starts by calculating the premium each asset class has earned over the risk-free rate of return. The premium is then adjusted, or tweaked, based on possible economic scenarios that may affect the asset class over the next five years. The adjusted premium is then added to the anticipated risk-free rate of return over the next five years (the anticipated rate of inflation also could be used as a proxy) to come up with the final modeled return.

Substantiation

Employee Retirement Income Security Act of 1974 [ERISA]

Sections 404(a)–(c), 408(b)(14) and (g).

Pension Protection Act of 2006 [PPA], Section 601(a)(1) and (2).

CFP Code of Ethics and Professional Responsibility

Rules 202, 701, 703

NASD Rules

NASD Conduct Rule 2310 ("Know Your Customer" Rule)

Practice A-2.5

Selected asset classes are consistent with the identified risk, return, cash flow needs, and time horizon of the client. Specific asset classes or investments not desired by the client are also discussed, identified, and documented by the fiduciary adviser.

Discussion

The fiduciary adviser's role is to recommend the appropriate combination of asset classes that optimizes each client's identified risk and return objectives, consistent with the client's time horizon and constraints of the plan's investment options. In the event the client relies on a certified computer model approved by the plan sponsor, his or her role should be to explain the asset allocation recommended by the model as suitable to the client's investment objectives.

There is increasing interest by some investors to in corporate social, ethical, moral, and/or religious criteria into their investment strategy, that is, to align investment decisions with the client's core values. A socially responsible investing (SRI) strategy may be challenging to incorporate into the limited universe of investment options of a qualified plan. Generally speaking, fiduciary standards of care, however, would not be abrogated if a fiduciary adviser were unable to accommodate the pursuit of a SRI strategy.

Suggested Procedure

If the client is not relying on a certified computer model for advice, computer optimization models utilized by the fiduciary adviser can mathematically assist him/her in determining different optimal asset mixes. Yet these technological tools and comprehensive databases have not reduced the asset allocation decision to a computerized, mathematical solution. "Soft" factors that the fiduciary adviser should consider:

- Time horizon of the client (Practice 2.2)
- Risk level of the client (Practice 2.3)
- Expected return necessary to meet client's goals and objectives (Practice 2.4)
- Asset class preferences of the client

Separate from portfolio optimization, fiduciary advisers should discuss with the client the potential tax implications of taking a loan from the account (including payment of outstanding loan amounts upon termination of employment), potential income tax ramifications of non-payment of outstanding loans, and penalties for withdrawal of assets prior to age 59?. Recent 401(k) survey data indicates, for example, that 10 percent of eligible plan participants in their sixties have loans outstanding and 19 percent of all ages have outstanding loans. Although these loans are typically less than 10 percent of the account balance, fiduciary advisers should make the client aware of potential problems with loans.[1]

Note: Tax status of the client is usually an important factor to consider in taxable portfolios. However, with the exception of the new Roth 401(k) plans, qualified plan status generally eliminates capital gains or marginal income tax rates as a factor in portfolio optimization—at least prior to retirement.

CRITERIA

2.5.1 Assets are efficiently diversified to conform to the client's specified time horizon and risk/return profile.

2.5.2 Selected asset classes provide each client the ability to diversify his or her portfolio appropriately given their time horizon and risk/return profile.

2.5.3 The methodology and tools used to establish portfolio diversification for the client are appropriate and consistently applied by the fiduciary adviser.

2.5.4 The fiduciary adviser determines whether the client has any socially responsible investment needs and whether these can be effectively addressed within the current advice program.

2.5.5 The fiduciary adviser discusses with the client any concerns with the investment options or computer-generated asset allocations provided under advice program that he or she believes are inconsistent with the client's overall investment objectives for retirement

Substantiation

Employee Retirement Income Security Act of 1974 [ERISA]

Sections 404(a)–(c) and 408(b)(14) and (g).

Pension Protection Act of 2006[PPA], Section 601(a)(1) and(2).

CFP Code of Ethics and Professional Responsibility

Rules 202, 701, 703, 704

NASD Rules

NASD Conduct Rule 2310 ("Know Your Customer" Rule)

Practice A-2.6

The client's investment policy statement contains sufficient detail to define, implement, and monitor the investment strategy.

CRITERIA

2.6.1 The client's IPS defines the duties and responsibilities of all parties involved.

2.6.2 The client's IPS defines diversification and rebalancing guidelines consistent with specified risk, return, time horizon, and cash flow parameters.

2.6.3 The client's IPS defines the due diligence criteria for selecting investment options within the qualified plan.

2.6.4 The client's IPS defines the monitoring criteria for the investment options.

Discussion

The preparation and maintenance of a client's investment policy statement (IPS) is one of the most critical functions performed by the fiduciary adviser, even if it is not stipulated by law or regulation. The IPS should be developed even if the client relies upon a certified computer model for investment advice. The IPS should be viewed as the business plan and the essential management tool for investment recommendations and assisting the client in implementing the recommendations within the client's retirement account. While the typical IPS in an advice program may not be as complex or lengthy a document as an IPS written for a high net worth client, the strategies are similar. Both allow the fiduciary adviser to coordinate the management of a client's investment program within a logical and consistent framework. All material investment facts, assumptions, and opinions should be included.

The fiduciary adviser should manage investment decisions with a reasonable level of detail. By reducing the details to writing and incorporating them into a written IPS, the fiduciary adviser can: (1) avoid unnecessary differences of opinion and resulting conflicts with clients; (2) minimize the possibility of missteps due to a lack of clear guidelines; and (3) establish a reasoned basis for measuring success, both in terms of meeting the client's objectives and the terms of the advice program.

Among the benefits of having a well-written IPS:

1. It supports the "paper trail" in the event of an audit, litigation, and/or a dispute. One of the first documents a regulator or an independent auditor of an eligible investment advice arrangement is likely to review is the IPS, because it should provide an outline of the client's overall investment strategy.
2. It helps to insulate the fiduciary adviser and the client from "market noise." During periods of over- and under-confidence in the capital markets, the IPS helps to keep the client focused on the long-term goals and objectives.
3. The IPS should have sufficient detail so that the client can implement the investment strategy, but not be so detailed as to require constant revisions and updates. Written addenda should be used to identify client information that will change on an infrequent basis, such as life-changing events like marriage or an inheritance.

One of the challenges of writing an IPS is to create investment guidelines specific enough to clearly establish the parameters of the desired investment process, yet provide enough latitude so as not to create an oversight burden. This is particularly true when establishing the client's asset allocation and rebalancing limits.

Rebalancing is required to maintain proper diversification, where the goal is to ensure that the client's portfolio does not stray far from its targeted levels of risk and return. An optimal portfolio can only be maintained by periodically rebalancing it to maintain the appropriate diversification. The fiduciary adviser should discuss with the client how to do this, since the initial asset allocation and rebalancing is ultimately the responsibility of the client. The fiduciary adviser will not take discretion over client assets as part of an advice program.

By establishing specific asset allocation parameters, it is much easier to determine whether a prospective money manager or mutual fund fits into the approved investment program. The fiduciary adviser should investigate the qualities, characteristics, and merits of a money manager, should one be available as part of the qualified plan, and also identify the role the money manager or mutual fund options play in the investment strategy. However, such an investigation and the related analysis cannot be conducted in a vacuum—it must be within the context of the needs of the investment strategy. Once the needs have been defined, and the general strategies developed, specific money managers or mutual funds should be chosen within the context of this strategy.

It is also important to remember that since the fiduciary adviser will not hold investment discretion over the client account (but only provide advice and recommendations), he or she will have a reduced "duty to monitor" the investment performance of the account. Nonetheless, to the extent possible, the fiduciary adviser should ensure that the client is aware of their mutual responsibilities in implementing and monitoring the investment recommendations.

Substantiation

Employee Income Security Act of 1974 [ERISA]

Sections 404(a)–(c) and 408(b)(14) and (g).

Pension Protection Act of 2006 [PPA], Section 601(a)(1) and (2).

CFP Code of Ethics and Professional Responsibility

Rules 202, 701, 703, 704

NASD Rules

NASD Conduct Rule 2310 ("Know Your Customer" Rule)

Endnote

[1] See EBRI study, at 14.

PRACTICE A-3.1

THE FIDUCIARY ADVISER SHALL ASSIST THE CLIENT IN UNDERSTANDING THE IMPLEMENTATION PROCESS.

CRITERIA

3.1.1 The fiduciary adviser discusses with the client the process and tools that are used to implement the asset allocation plan.

Discussion

Financial planners and investment managers who typically hold discretion over client portfolios will undertake a new challenge as fiduciary advisers—helping the client do it on his or her own. The fiduciary adviser should develop a simple process that can easily be understood by clients and replicated outside of the office. The process may be as simple as going over a sample trade or automatic rebalance feature on an office computer with the client.

As noted previously, the fiduciary adviser should not request or be given access to the client's username or password to an online account to implement the plan, even on a temporary basis. Such access could trigger inadvertent custody of client funds, unless the fiduciary adviser's firm adheres to applicable banking or securities law custody rules and ERISA bonding requirements. Further, such access could result in the fiduciary adviser assuming greater fiduciary duties by his or her actions than what was contemplated in the original engagement.

Suggested Procedure

The fiduciary adviser should follow up with the client after a reasonable period of time to ensure that the client understands the mechanics involved and has implemented the new asset allocation plan.

Substantiation

Employee Retirement Income Security Act of 1974 [ERISA]

Sections 404 (a)–(c) and 408 (b)(14) and (g).

Pension Protection Act of 2006 [PPA], Section 601(a)(1) and (2).

CFP Code of Ethics and Professional Responsibility

Rules 202, 701

Practice A-3.2

The fiduciary adviser shall comply with applicable "safe harbor" provisions under section 601.

Discussion

Although the client would have received copies of appropriate plan documents, an advisory agreement, and any necessary disclosure documents at the onset of the engagement, the fiduciary adviser should be aware of ongoing requirements during the implementation and monitoring phases.

Compensation received by the fiduciary adviser must be a "level fee" if the client does not rely on a certified computer program to provide investment advice. Unless the Department of Labor provides further guidance on this topic, the fiduciary adviser should ensure that the fees charged for do not vary depending on the investment options chosen by the client. The Department of Labor, in recent guidance, has clarified that only the fees to the fiduciary adviser, not an affiliate of the fiduciary adviser, may vary. An affiliate of the fiduciary adviser (that is, a registered investment adviser, a bank or similar financial institution, an insurance company, or a registered broker-dealer) will be subject to the varying fee limitation only if that affiliate provides investment advice to plan participants and beneficiaries. However, if a person provides investment advice to participants and beneficiaries in the capacity of an employee, agent, or registered representative on behalf of an entity that is a fiduciary adviser, that person, as well as the entity will be treated as a fiduciary adviser subject to the varying fee limitation in Section 601 of the PPA. [See Field Assistance Bulletin 2007-1.] This provision of the law was designed to help ameliorate the potential conflict of interest in selecting investment options in those cases where the fiduciary adviser or its firm receives a higher payout based on the investments selected by the participants or beneficiaries.

In addition, Sec. 601 of the Act also requires the fiduciary adviser to provide, prior to providing any advice, detailed disclosures about all fees and other compensation that the fiduciary adviser and any affiliate may receive (including compensation from third parties) in connection with the provision of participant advice and in connection with the sale, acquisition, or holding of security or other property offered as investment options under the plan. Material changes to the information should be provided to participants and beneficiaries "at a time reasonably contemporaneous to the change in information," according to the Act. For example, one should assume material changes in information may include additions or eliminations of investment options in the plan, methods of compensation, or to business contracts affecting the advice program, such as replacement of the eligible investment expert.

Suggested Procedure

The fiduciary adviser should identify the types of material changes to the information that it would need to provide to the client on a timely basis, determine who is responsible for handling that task if the fiduciary adviser is unavailable, and consider the information delivery method to ensure that the client receives it in a timely manner.

Criteria

3.2.1 Fees received by the fiduciary adviser under the eligible investment advice arrangement do not vary relative to the recommended investment options (unless the fees are based on investment advice from a certified computer program).

3.2.2 Disclosure to the client of any material change in information is provided to the client within a reasonable period of time following the change in information.

Substantiation

Employee Retirement Income Security Act of 1974 [ERISA]

Sections 404(a)–(c), 408(g)(6) and (8).

Pension Protection Act of 2006 §601(a)(2)

Investment Advisers Act of 1940

§ 275.204-3 (Brochure Rule)

CFP Code of Ethics and Professional Responsibility

Rules 202, 401–404

Step 4: Monitor

Practice A-4.1

Periodic reports compare investment performance against an appropriate index and/or peer group, and IPS objectives.

Discussion

The fiduciary adviser's monitoring function extends beyond a strict examination of portfolio performance. By definition, monitoring occurs across all policy and procedural issues previously addressed in this handbook.

In keeping with the duty of prudence and care, a fiduciary adviser must determine the frequency of portfolio reviews, taking into account such factors as: (1) prevailing general economic conditions, (2) the size of the client's portfolio, (3) the investment strategies employed, (4) the investment objectives sought, and (5) the volatility of the investments selected. Unlike large brokerage platforms, the generally limited number of investment options in a qualified plan should make this goal much easier to accomplish.

The fiduciary adviser should establish performance objectives for each investment option in the plan, and record the same in the client's IPS. Investment performance should be evaluated in terms of an appropriate market index and the relevant peer group. The IPS also should describe actions to be taken when an investment option fails to meet the established criteria.

In the absence of any pressing issues regarding the individual client, the fiduciary adviser should review the plan's investment options at least quarterly and the client's individual portfolio at least once annually.

During the annual review, the fiduciary adviser should determine whether a client's portfolio requires rebalancing. If it does, the fiduciary adviser should so advise the client.

Substantiation

Employee Retirement Income Security Act of 1974 [ERISA]

Sections 404(a)–(c) and 408(b)(12) and (g)(6) and (8).

CFP Code of Ethics and Professional Responsibility

Rules 202, 701, 703, 704

Criteria

4.1.1 The performance of each investment option is compared at least annually to an appropriate benchmark and/or peer group, and due diligence procedures are defined in each client's IPS.

4.1.2 The information that is provided in performance reports is relevant to each client's circumstances.

4.1.3 The fiduciary adviser provides the client with a "watch list" and procedures to be followed in monitoring underperforming investment options.

4.1.4 The fiduciary adviser provides the client with a process of how to periodically rebalance assets in the ERISA plan portfolio.

Practice A-4.2

Periodic reviews are made of qualitative and/or organizational changes of investment managers or other investment decision-makers.

CRITERIA

4.2.1 The fiduciary adviser shall periodically evaluate the qualitative factors that may affect the investment offerings within the plan, including corporate stock of the plan sponsor.

4.2.2 If the fiduciary adviser becomes aware of unsatisfactory news regarding a material holding in the client's portfolio, the fiduciary adviser will notify the client in writing, in a timely manner, and in a way designed to catch the client's attention.

Discussion

Given studies that show many plan participants continue to invest heavily in their employer's stock—notwithstanding the lessons from Enron—the fiduciary adviser should in particular monitor the performance of any company stock in the client's portfolio. Further, the fiduciary adviser should be aware of Section 901(b) of the PPA which amended ERISA to require diversification of publicly-traded employer stock held in defined contribution plans which are not employee stock option plans (ESOPs) under certain circumstances. The fiduciary adviser should also periodically evaluate all other investment options to determine suitability for investment when diversification or other changes in asset allocations are warranted or required. If fees and expenses for investment options change significantly, or would have a long-term drag on the client's rate of return, these should be flagged and the client notified in writing of the fiduciary adviser's concerns.

What is unsatisfactory news? Unsatisfactory news about any investment options that may have only an immediate, short-term effect may not require notice to the client—it may simply be "market noise." However, if the news has the potential for a long-term effect on the client's retirement objectives, then the fiduciary adviser should apprise all clients in the eligible investment advice arrangement of the event, both good news and bad.

Substantiation

Employee Retirement Income Security Act of 1974 [ERISA]

Sections 404(a)–(c).

CFP Code of Ethics and Professional Responsibility

Rules 202, 701, 703, 704

Practice A-4.3

Fees for advisory services provided by the fiduciary adviser are reasonable and consistent with agreements and all applicable laws.

Discussion

Unlike the complexity of fee and soft dollar arrangements available outside of an eligible investment advice arrangement, the requirements under Section 601 are relatively straightforward. The fee must be "level" and the advisory fee charged by the fiduciary adviser "reasonable" and "at least as favorable to the plan as an arm's length transaction." If the level fees are paid by the plan sponsor, then the reasonableness inquiry need not be necessary, although the competitiveness of the arrangement in the marketplace will obviously affect the fees charged. However, Section 601 of the PPA allows the use of plan assets to pay for reasonable expenses in providing investment advice. Thus, the fiduciary adviser must be concerned with whether the fees charged to the plan for the investment advice are at least within industry norms and, of course, level, that is, not based on any incentives that would create a conflict of interest with the adviser's fiduciary duty to the client. Industry norms might include the experience level and qualifications of the fiduciary adviser, the size of the plan, and the number of participants. However, with the introduction of a new "fiduciary adviser" under ERISA, what constitutes a reasonable fee in helping plan participants with widely varying personal situations is unclear. Financial services representatives should become familiar with the fees charged by competitors offering advice programs, and whether the fiduciary adviser believes its own fees are reasonable in light of services provided.

Another factor that the fiduciary adviser should consider is that the plan sponsor or other plan fiduciary has the responsibility of monitoring the services provided and ensuring that the fees charged for the services provided are reasonable. The reasonableness of fees also applies to fiduciary advisers who provide computer advice as well.

It is anticipated that the Department of Labor may provide guidance in the near future on what is meant by a "reasonable" fee under ERISA. In recent guidance, the Department of Labor described some factors for fiduciaries to consider in monitoring these arrangements, including: (1) the extent to which there have been any changes in the information that served as the basis for the initial selection of the fiduciary adviser; (2) whether the fiduciary adviser continues to meet applicable federal and state securities law requirements; (3) whether the advice being furnished to participants and beneficiaries was based on generally accepted investment theories; (4) whether the provision of investment advice by the fiduciary adviser is complying with the contractual provisions of the engagement; (5) the overall utilization of the investment advice services by the participants in relation to the cost of the services to the plan; and (6) participants' and beneficiaries' comments and complaints concerning the quality of advice being provided to them. [Field Assistance Bulletin 2007-01].

Criteria

4.3.1 The fees paid to the fiduciary adviser are periodically examined to determine whether they are consistent with service agreements and reasonable as required by ERISA and Section 601 of the Act.

4.3.2 The fees being paid to the fiduciary adviser are periodically compared to industry peer groups and/or benchmarks.

Substantiation

Employee Retirement Income Security Act of 1974 [ERISA]

Sections 404(a)–(c), 408(b)(2), 408(b)(14) and (g)(2), (7)(c) and (d), (10)(B) and(C).

Pension Protection Act of 2006 [PPA}, Section 601(a)(2).

CFP Code of Ethics and Professional Responsibility

Rules 202, 405

Practice A-4.4

There is a process to periodically review the fiduciary adviser's effectiveness in meeting his or her fiduciary responsibilities.

Discussion

Fiduciary duties generally are presented as distinct obligations substantiated through law, regulations, and case law. In some respects, the annual independent audit requirement required by the PPA may allow identification of deficiencies on a timely basis. However, the Department of Labor needs to provide some guidance on what the independent auditors are to examine in issuing their annual audit reports to the plan sponsor or other fiduciary. Many of the duties under an eligible investment advice arrangement are accompanied by documentation and review obligations. However, the fiduciary adviser should not assume the annual audit requirement under the PPA will satisfy ERISA's overall prudence standard for the fiduciary adviser. As a practical matter, a comprehensive framework is needed to ensure that all applicable fiduciary practices are fully and effectively addressed on an ongoing basis. A planned approach to conduct periodic reviews within the fiduciary adviser's firm provides such a framework.

Verification of fulfillment of the best practices thus goes beyond the basic requirements of the Act and requires an objective evaluation of evidence related to compliance with the prudent practices. While there are no legal or regulatory requirements for regularly documented fiduciary reviews, a fiduciary adviser would be well-served to demonstrate a genuine commitment to fulfill the best practices and hence the fiduciary obligations required in giving investment advice to plan participants and beneficiaries.

This review would be consistent with the well-established fiduciary principle of documented procedural due diligence. Moreover, the prudent expert standard is one that benchmarks the performance of the fiduciary adviser against the highest standards in the industry. Given that internal and external reviews are recognized tools to evaluate risks and ensure the effectiveness of policies and procedures, further weight is added to the need to establish a formal process of in-house reviews.

Finally, it is important to recognize that the trend in law and regulation is towards greater formality in: (1) policies and procedures and (2) processes to ensure that the policies and procedures are effective.

Suggested Procedure

The fiduciary adviser should address the following questions at least once a year following the report from the independent auditor (assuming it is provided to the fiduciary adviser) as well as in reviewing adherence to the prudent practices contained in this handbook:

- What were the findings of the annual independent audit?
- Were there any material or minor deficiencies reported?
- What actions should the fiduciary adviser take in response to these problems?

CRITERIA

4.4.1 The fiduciary adviser's role in an eligible investment advice arrangement is periodically reviewed and improved as needed.

4.4.2 Each client's IPS is reviewed at least once a year.

4.4.3 Reviews are conducted at planned intervals to determine whether (a) appropriate policies and procedures are in place to address the fiduciary adviser's fiduciary obligations, and (b) such policies and procedures are implemented and maintained.

4.4.4 Internal reviews by the fiduciary adviser's firm are conducted in a manner that ensures objectivity and impartiality.

- What components among the prudent practices were actively reviewed?
- Was the prudent practices review narrowly focused on procedures or was a broader approach taken in looking for unexpected problems?
- How was the review conducted? (Was it a "checklist" approach, or was it so-called forensic testing, for example, reviewing variances in asset allocations between different portfolios to ensure the individual investment objectives of each client were addressed?)
- What were the recommendations, if any, for changes to procedures?
- What is the status of those recommendations three months later? (Were they shelved?)
- What documentation by the fiduciary adviser's firm was retained to reflect the changes made?

Regarding the client's IPS:

- Has the client rebalanced the portfolio on a regularly scheduled basis?
- Did the client report any significant life changes that may require a review of the current asset allocation?
- Has the IPS been periodically reviewed with the client and any changes discussed and implemented by the client?

Substantiation

Employee Retirement Income Security Act of 1974 [ERISA]

Sections 404(a)–(c) and 408(g)(5)–(9).

Pension Protection Act of 2006 [PPA] Section 601(a)(2).

CFP Code of Ethics and Professional Responsibility

Rules 202, 606, 701

Sample Arrangement Letter between Fiduciary Adviser and Plan Sponsor

(Date)

(Plan Sponsor)
(Address)
Personal & Confidential

This arrangement letter should be reviewed by an attorney knowledgeable in this specific area of the law before execution by either party.

Ref: Arrangement Letter, Authorization to Function as a Fiduciary Adviser

Dear (Plan Sponsor Client):

This letter sets forth our understanding of the nature and the scope of services I have been engaged to perform and the related fees and other terms and conditions designed to be in compliance with the Pension Protection Act of 2006 (PPA or Act).

1. Fiduciary Acknowledgment
You have given me the express authorization to function as a fiduciary adviser as defined by the Act. As a fiduciary adviser to the plan, I hereby acknowledge my fiduciary status to the plan and to the plan's participants and beneficiaries.

2. Disclosure of Conflicts of Interests
I am not aware of any conflicts of interest between myself, the plan, the plan participants and beneficiaries, and/or any of the plan's other vendors.

- or -

I am aware of the following potential conflicts of interests between myself, the plan, the plan participants and beneficiaries, and/or any of the plan's other vendors:

[List conflicts]

3. Disclosure of all Forms of Compensation
The only form of compensation I will receive for my services is the fee of $____ per participant [or ___ basis points], based on the value of all plan assets at the end of the quarter. My fee is payable within 30 days at the end of the quarter.[Insert a provision, if applicable, that the fee will be paid by the plan sponsor or will be deducted directly from the participants' accounts.]

- or -

My base fee is $____ per participant [or ___ basis points], based on the value of all plan assets at the end of the quarter. Any additional compensation is summarized in the enclosed Department of Labor model fee disclosure form.[1]

[List other sources of direct and indirect compensation received by the fiduciary adviser as part of the eligible investment advice arrangement]

4. Scope of Services
I will provide specific investment advice to plan participants and beneficiaries utilizing an "eligible investment advice arrangement," defined as advice that is generated by a computer-driven model, and/or is fee-neutral (my compensation is not affected by which fund family, fund, share class, and/or asset mix is suggested).

5. Information about My Investment Process
I am enclosing a brochure [Form ADV, or other suitable disclosure document] which describes my qualifications, and information about my firm and investment process.

6. Participant Information
I will base my advice on information provided by the individual plan participants and beneficiaries, and I will consider this information provided by them and/or you, the plan sponsor or other fiduciary, to be reliable and accurate. I cannot guarantee the accuracy of this information.

It is understood that investment decisions are at the direction of each participant or beneficiary.

7. Maintenance and Location of Files
I will be maintaining at my main office, located at [street address], for no less than six years, all documents pertaining to my investment process and the advice that I provide to the plan participants and beneficiaries.

8. Confidentiality
All information and advice shall be treated as confidential and shall not be disclosed to any third party except as agreed upon in writing between the participant or beneficiary and myself or as otherwise required by law.

9. Warrants
You have warranted to me that you are an "independent plan fiduciary" as defined by the Act, and that you are authorized to enter into this arrangement. Furthermore, that if a computer-driven advice model is being utilized, the model has been certified by an independent fiduciary expert.

10. Indemnification and Limitation of Liability.
You shall indemnify and hold me harmless from and against any and all third-party claims (and directly resulting demands, actions, suits, proceedings, losses, damages, costs, charges, reasonable counsel fees, payments, expenses, and liabilities) resulting from this arrangement, except to the extent the claims are directly and proximately caused by my negligence or willful misconduct. I shall indemnify and hold you harmless from and against any and all third-party claims (and directly resulting demands, actions, suits, proceedings, losses, damages, costs, charges, reasonable counsel fees, payments, expenses, and liabilities) directly or proximately caused by my negligence

or willful misconduct in providing services under this arrangement.

Neither of us shall be liable to the other for any good faith error of judgment or mistake of law arising out of any act or omission on the part of the other or any third party (including, without limitation, money managers, brokers, custodians, or other service provider).

11. Termination.
Initially, you may terminate this arrangement by written notice to me within five (5) business days from the execution of this arrangement and all fees will be refunded. Thereafter, either party upon thirty days (30) written notice to the other may terminate this arrangement. Termination will not affect the liabilities or obligations of the parties under this arrangement arising from work already completed. Notice of termination shall be provided to the participants of the plan at the same time that it is provided to the other party.

12. Severability
If any of the provisions of this arrangement shall be held invalid by statute, rule, regulation, decision, or tribunal or otherwise, the remainder of this arrangement shall not be affected, and, to such extent, the provisions of this arrangement shall be severable.

13. Exclusivity
I will not be prevented or restricted by anything in this arrangement from providing services of this nature for other clients.

14. Entire Arrangement
This arrangement constitutes the entire agreement between the parties and can be amended only by a written document signed by both parties.

I appreciate the opportunity to perform these services for you. If you have any questions regarding the scope of my services or estimated fees, please call me at __________________.

Sincerely,

______________________________ (Fiduciary Adviser)

______________________________ (Name of Firm)

Please indicate your acceptance of the arrangements described by signing at the designated line below.

____

Plan Sponsor (or other fiduciary) signature

____

Date

Endnote
[1] A model disclosure statement from the Department of Labor is expected to be promulgated in the near future.

Sample Acknowledgment Letter between Fiduciary Adviser and Plan Participant

Date:

My name is ________________________________, and I work for the firm of

_____________________________________.

I have been hired by [name of plan sponsor] to serve as a "fiduciary adviser." As a fiduciary adviser, my job is to provide you with advice on how you might best manage your 401(k) [or other qualified plan name] portfolio. The ultimate decision on how your money is invested is still your responsibility.

As a matter of law, I am required to provide you certain information:

1. I am serving in a fiduciary capacity under ERISA with respect to providing participant investment advice; simply stated, your interests come first.

2. I am not aware of any conflicts of interest between myself, the plan that is offered by [plan sponsor's name], and/or any of the plan's other vendors.

   - or -

   I am aware of the following potential conflicts of interests between myself, the plan that is offered by [plan sponsor's name], the plan participants and beneficiaries, and/or any of the plan's other vendors:

   [List conflicts]

3. I am not affiliated with any of the plan's vendors.

   - or -

   I am affiliated with the following vendors to the plan:

   [List affiliations]

4. The only form of compensation I will receive for my services is the fee of $____ per participant [or ___ basis points], based on the value of all plan assets at the end of the quarter. [Something should be put inhere about who will be paying the fee—will it be the plan sponsor or will it be the participant through deduction from the participant's account ?]

   - or -

   My base fee is $____ per participant [or ___ basis points], based on the value of all plan assets at the end of the quarter. However, in addition I receive compensation from the following sources and in the following amounts:

[List other sources of compensation and amounts.]

In addition to my compensation and fees, the affiliated vendors to the plan also receive the compensation from the following sources and in the following amounts:

[List sources of compensation and amounts.]

5. If you wish to utilize my services I will guide you through the following four step process:

   Step 1 Organize—I will gather pertinent information about you and begin to create an investment policy statement (IPS), which will serve as the basis for your retirement advice.

   Step 2 Formalize—Based on your responses to various questions about investment risk and investment return, I will suggest an appropriate asset allocation. The asset allocation will be based on a retirement planning model developed [or used] by my firm, or from a certified computer program approved by the plan sponsor.

   Step 3 Implement—I will provide you information on how you should implement your investment strategy; the mutual funds [or investment options] selected to implement your strategy, and the allocation to each fund [or investment option]. Only you can direct how your investments are implemented.

   Step 4 Monitor—We will meet on an annual basis to review your IPS, and discuss whether you need to rebalance your portfolio, make changes to your asset allocation, and/or change your mutual fund selections. You will contact me in the interim if you have a life-changing situation, such as a change in job or marital status, that you think may affect your long-term retirement goals.

6. When you receive your IPS, it will include the historical performance of each investment option available through the plan.

7. The information you provide to me, as well as the information I provide to you under this arrangement, will be kept strictly confidential and will not be disclosed by me to anyone without your express written consent. Information may be provided to other persons in my firm or to third-parties on an as-needed basis solely for the purpose of providing services to you under this arrangement.

8. You are not limited to my advisory services. You may also consult with other investment advisers who are not affiliated with any of your employer's vendors.

If I can be of any assistance, please let me know.

Sincerely,

________________________ ________________________

Fiduciary Adviser Employee

Sample Investment Policy Statement (IPS)

Step 1 Organize

Participant Name________________________ Date Prepared________________________

Fiduciary Adviser________________________ Adviser's Firm________________________

Current Account Balance $________________ Annual Contribution Amount $________

Additional Retirement Assets

Defined Benefit Plan $_______________ Spousal Retirement Benefits $__________

Savings $___________________________ Other (Define) ___________ $__________

Estimated Assets $__________________ Estimated Liabilities $________________

Notes on any existing cash flow issues:

Step 2 Formalize (RATE)

Risk Tolerance

Investment Knowledge
___Know a little
___Know some
___Know a lot
___ Years I have invested in the stock market

Risk Tolerance Scale
___I don't want to lose any money.
___I can take some investment risk.
___I can take a lot of risk, knowing I may also lose a lot of money.

Asset Class Preferences

___Make the plan's entire asset classes available

___Restrict the following asset classes: ________________________________

Notes on any restrictions to asset classes:

Time Horizon

Age___ Years until Retirement________

Life Expectancy___(actuarial chart) Estimated Years in Retirement_________

Expected Return

Targeted (Desired) Investment Return (not including inflation)

___4% ___6% ___8% ___10%

Proposed Allocation

Proposed	Model	Percentage Stocks	Percentage Bonds	Model Risks	Model Returns
	Model A	20%	80%	0	4.0%
	Model B	40%	60%	-4.0%	6.0%
X	Model C	60%	40%	-8.0%	8.0%
	Model D	80%	20%	-12.0%	10.0%

Step 3 Implement

Suggested Investement Options and Allocations

Fund Name	Peer Group	Allocation
Mutual Fund A	Large Cap Equity	30%
Mutual Fund B	Mid Cap Equity	10%
Mutual Fund C	Small Cap Equity	10%
Mutual Fund D	International Equity	10%
Mutual Fund E	Intermediate Fixed Income	30%
Mutual Fund F	Short-term Fixed Income	10%

Step 4 Monitor

High Performance (as of Dec 31, 2006)

Fund Name	Peer Group	1 Yr	2 Yr	3 Yr
Mutual Fund A	Large Cap Equity	3.2%	2.8%	7.4%
Mutual Fund B	Mid Cap Equity	3.2%	2.8%	7.4%
Mutual Fund C	Small Cap Equity	3.2%	2.8%	7.4%
Mutual Fund D	International Equity	3.2%	2.8%	7.4%
Mutual Fund E	Intermediate Fixed Income	3.2%	2.8%	7.4%
Mutual Fund F	Short-term Fixed Income	3.2%	2.8%	7.4%

Suggested portfolio rebalancing schedule:

___ Annually, each December or
___ Quarterly, March, June, September, December
___ Other

Moving Forward

Your responsibilities:

1. You must implement the proposed strategy if you believe it is appropriate.
2. You will contact me prior to our annual meeting if you have any significant change in your financial situation, such as a promotion at work or marital status, that could affect your retirement goals.

My responsibilities: I will meet with you on an annual basis to review your IPS and discuss whether you need to rebalance your portfolio, make changes to your asset allocation, and/or change your mutual fund [or other investment] selections.

____
Plan Participant Date

____
Fiduciary Adviser Date

Executive Summary

Section 601 of the Pension Protection Act of 2006

The best practices contained in the handbook are intended to conform to a number of financial services laws and regulations affecting financial planners and others who provide personalized advice to their clients on qualified plans. In addition, the best practices address the requirements of Section 601 of the Pension Protection Act of 2006, which allows investment advice to be provided to employees with 401(k) and other participant-directed account plans, notwithstanding potential conflicts of interest. By meeting the requirements of Section 601, fiduciary advisers are provided with a safe harbor from the prohibited transaction restrictions of ERISA, which generally prohibit an ERISA fiduciary from, among other things, receiving compensation such as 12b-1 fees or other third-party compensation. Thus, where a plan fiduciary received fees or other compensation from the investment options under the plan that were either undisclosed or did not offset other fees to which they were entitled for providing services to the plan or its participants, a prohibited transaction under ERISA could occur.

Please note that there are also parallel provisions in the Internal Revenue Code relating to prohibited transactions with respect to investments held in IRAs. Section 601 contains provisions directing the U.S. Department of Labor to promulgate rules related to fiduciary advisers providing advice to IRA account holders. Until those rules are written, however, this overview is limited to advice provided only with regard to ERISA-covered plans.

Here are the key provisions with which fiduciary advisers should be familiar:

ERISA Section 408(g)(2). Eligible Investment Advice Arrangement.
The term applies to any agreement between a fiduciary adviser and plan sponsor or other ERISA fiduciary for the provision of investment advice to participants under either one of the following arrangements: (1) the fees charged by the fiduciary adviser will not vary, no matter the investment option selected by the client ("independent advice"); or (2) the fees charged may vary depending on the investment options selected by the participant, but the advice is provided through the use of a computer model ("computer advice").

ERISA Section 408(g)(3). Computer Model Investment Advice Program.
Computer models used to provide investment advice to plan participants must meet the following requirements.

ERISA Section 408(g)(3)(B). Software Requirements.
The computer model must:

- Take into account historic returns of different asset classes over defined periods of time, that is, Modern Portfolio Theory
- Use relevant information about the client, which may include age, life expectancy, retirement age, risk tolerance, other assets or sources of income, and preferences for certain investments

- Use objective criteria to provide asset allocation portfolios comprised of investment options available under the plan
- Not operate in a biased manner that favors investments offered by the fiduciary adviser or person with a material affiliation with the fiduciary adviser
- Take into account all investment options under the plan and is not inappropriately weighted with respect to any investment option

ERISA Section 408(g)(3)(C)(i) and (ii). Certification of Computer Advice Program.
The PPA requires an independent certification of the computer software program's compliance with the requirements listed above in ERISA Section 408(g)(3)(B). An "eligible investment expert" must certify the program prior to use, and whenever there has been a material modification to the computer program.

ERISA Section 408(g)(3)(C)(iii). Qualifications of Investment Expert.
The Department of Labor will establish qualifications for the eligible investment expert in the near future. Such experts are prohibited from having a material or contractual relationship with an "investment adviser" or related person of the adviser.

ERISA Section 408(g)(3)(D). Exclusivity of Advice Given under Computer Advice Program.
Advice given by the fiduciary adviser under the computer advice program must be exclusively the advice generated by the computer model, unless the client requests other advice without solicitation by any person connected with the fiduciary adviser program. The client must self-direct the investment of his or her assets.

ERISA Section 408(g)(4). Authorization of Advice Program.
The advice program (whether independent advice or computer advice) must be authorized by a plan fiduciary other than the person offering the advice program, or any person providing investment options under the plan, or an affiliate of either.

ERISA Section 408(g)(5). Annual Audit of Fiduciary Adviser Program.
Separate from certification of the advice program (whether independent advice or computer advice), the eligible investment advice arrangement is required to be audited once a year by an "independent auditor." Such person must have appropriate technical experience or training and proficiency and not be related to the fiduciary adviser or to any person offering the investment options under the plan. The auditor is required to review compliance with Section 601 requirements and to issue a written report of its findings to the fiduciary that approved the eligible investment advice arrangement.

ERISA Section 408(g)(6)(A). Disclosure Requirements by the Fiduciary Adviser.
The fiduciary adviser must disclose to the client, either in writing or by electronic communication, and prior to providing any investment advice, the following:

- The role of any party that has a material affiliation or contract with the fiduciary adviser in development of the advice program and/or selection of investment options in the plan.

- Past performance and historic rates of return of the investment options in the plan.
- All fees or other compensation that the fiduciary adviser or its affiliates will receive, including any compensation from a third party, in connection with the advice program and the sale, acquisition, or holding of the security or other property provided as investment options under the plan.
- Any material affiliation or contractual relationship of the fiduciary adviser with the securities or other property provided as investment options under the plan.
- How client information will be used or disclosed.
- Types of services provided by the fiduciary adviser as part of the advice program.
- That the fiduciary adviser is acting as a fiduciary of the plan.
- That the client may separately arrange for independent advice with a person not connected to the eligible investment advice arrangement or the security or other property offered as an investment option under the plan.

ERISA Section408 (g)(6)(B). Availability of Information to the Client and Annual Disclosure.
The fiduciary adviser must maintain the information above "in accurate form" and provide it without charge to the client at least once a year, or upon request, and at no charge. Equally important, the fiduciary adviser must provide the client with information regarding any material changes to the information provided above "at a time reasonably contemporaneous" to when it occurred.

ERISA Section 408(g)(8). Standards for Disclosure.
The disclosure provided to the client must be written in a "clear and conspicuous manner" calculated to be understood by the average plan participant.

ERISA Section 408(g)(9). Recordkeeping.
A fiduciary adviser must maintain any records related to the disclosure and other compliance requirements for at least six years after the provision of the advice.

ERISA Section 408(g)(10). Exemption for Plan Sponsor and Certain Other Fiduciaries.
A plan sponsor or other plan fiduciary (other than the fiduciary adviser) is considered to meet the requirements of Section 601 if the investment advice to clients is provided by the fiduciary adviser, the written agreement requires compliance by the fiduciary adviser with the requirements of Section 601, and the fiduciary adviser acknowledges in writing that it is a fiduciary of the plan in connection with the advice provided. The plan sponsor or other fiduciary cited above must continue to exercise prudence in the selection and periodic review of the fiduciary adviser, although they have no duty to monitor the specific advice provided to a client.

ERISA Section 408(g)(10)(C). Plan Assets May be Used to Pay for Participant Advice.
Plan assets may be used to pay for reasonable expenses associated with the provision of advice under the eligible investment advice arrangement.

ERISA Section 408(g)(11). Fiduciary Adviser Definition.
A fiduciary adviser means a person providing advice to plan participants or beneficiaries in a plan who is one of the following:

- State or federally registered investment adviser
- Trust department of a bank or similar financial institution
- Insurance company
- Broker-dealer
- An affiliate of any of the above
- Or an employee, agent, registered representative, or investment adviser representative of any of the above and who satisfies applicable insurance, banking, and securities laws related to the advice.

In addition, a person who develops the computer model or markets the advice program or software program is a fiduciary adviser, except to the extent that Department of Labor prescribes otherwise in its regulations.

Appendix C: Glossary of Terms

This glossary was compiled from the following sources:

CFP Code of Ethics and Professional Responsibility.

Donald B. Trone, William R. Allbright, and Philip R. Taylor, *Procedural Prudence for Fiduciaries*, self-published, 1997.

Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1 to 80b-21 (2000); 54 Stat.847 (1940).

Title VI of the Pension Protection Act of 2006.

Asset allocation. The process of determining the optimal allocation of a fund's portfolio among generally accepted asset classes.

Audit *(noun)*. A requirement of the Pension Protection Act of 2006, an independent third-party audit must be performed at least annually to determine compliance of the fiduciary adviser in an eligible investment advice arrangement with the requirements of the exemption under ERISA Section 408(g). (*See* definitions of "eligible investment advice arrangement" and "fiduciary adviser," below.)

Best practice (*noun*) (also referred to as a **prudent practice**). The details of a prudent process outlined in this handbook that a fiduciary adviser should follow in satisfying the requirements of an eligible investment advice arrangement as well as in setting an example of fiduciary excellence.

Client. An individual plan participant or beneficiary who is the recipient of investment advice as part of an eligible investment advice arrangement. For purposes of this handbook, the term "client" does not include a plan sponsor or other plan fiduciary who may be a separate client of a fiduciary adviser.

Client documents. As referenced in these best practices, client documents refers only to those written and electronic records, including disclosures, agreements, investment advisory recommendations, and privacy information related directly to an individual client, not a plan sponsor.

Criteria. The details of a defined best practice in connection with an eligible investment advice arrangement.

Eligible investment advice arrangement, or "**advice program**." A written agreement between a plan sponsor and a qualified fiduciary adviser in which the fiduciary adviser provides personalized advice to a client and satisfies certain conditions in order to meet the requirements for the prohibited transaction exemption under the Pension Protection Act of 2006 (Act or PPA).

Eligible investment expert. A person who meets the requirements of the Department of Labor for certifying a computer model to be used to provide personalized investment advice, and who does not have any material affiliation or contractual relationship with any investment adviser, agent or related person in the advisory firm.

ERISA. The Employee Retirement Income Security Act is a 1974 U.S. law governing the operation of most private pension and benefit plans. The law eased pension eligibility rules, set up the Pension Benefit Guaranty Corporation, and established fiduciary standards for the management of pension funds.

Fiduciary. From the Latin word *fiducia*, meaning "trust." Someone who stands in a special relation of trust, confidence, and/or legal responsibility. A fiduciary is held to a standard of conduct and trust above that of a stranger or of a casual business person due to the superior knowledge and/or training of the fiduciary.

Fiduciary adviser. A fiduciary adviser is a financial services firm or natural person affiliated with a firm who is a plan fiduciary by reason of providing investment advice to a client under an eligible investment advice arrangement, or advice rogram.

A fiduciary adviser must be registered as an investment adviser under federal or state law; a trust department of a bank or similar financial institution; an insurance company qualified to do business under state law; a broker-dealer; or an affiliate, employee, agent or registered representative of one of the above-named firms and who is in compliance with applicable insurance, banking, or securities laws relating to the provision of investment advice.

A fiduciary adviser also may be a firm or natural person who either develops a computer model investment advice program or markets the investment advice program or computer model under an eligible investment advice arrangement.

Independent auditor. A person with appropriate technical training who conducts an annual audit of the of the eligible investment advice arrangement for compliance with Section 601 of the Act and who is independent, that is, not affiliated with the firm offering the advice program or the firm providing the investment options under the plan.

Internal Revenue Code rules. In the context of these best practices, Code rules are generally parallel to ERISA prohibited transaction rules related to qualified retirement plans and an eligible investment advice arrangement. Code rules, unlike qualified plan requirements, are generally applicable to individual retirement accounts (IRAs) under a similar advice arrangement.

Investment adviser representative. An individual who is affiliated with a state or SEC-registered investment advisory firm. This term also refers to sole proprietors who may be registered as well as the firm.

Investment policy statement, or "**IPS**.". A written statement that outlines and prescribes a prudent and acceptable investment philosophy of the client and defines the investment management procedures and long-term goals of the investor.

Level fee. Although the term is not cited in the Pension Protection Act of 2006, a level fee in this handbook refers to the compensation, including commissions, received by the fiduciary adviser as part of an eligible ivestment advice arrangement. The arrangement "provides that any fees (including any commission or other compensation) received by the fiduciary adviser for investment advice…for purposes of investment of plan assets do not vary depending on the basis of any investment option selected," according to the Act.

Lifecycle fund. Also known as a "targeted retirement" fund, it is a hybrid mutual fund that typically rebalances to an increasingly conservative asset allocation as the target date of the fund (usually mentioned in the fund name) approaches.

Pension Protection Act of 2006, (PPA, or Act). Comprehensive reform legislation passed by Congress and signed into law by President Bush in August 2006 that updates federal pension laws. Among other things, the new law creates an exemption from the prohibited transaction rules of ERISA and the Internal Revenue Code with respect to a fiduciary adviser providing personalized investment advice for a fee or other compensation.

Prohibited transaction exemption. An exemption from the prohibited transaction rules under ERISA and parallel rules of the Internal Revenue Code (the "Code") for a fiduciary who otherwise may have an inherent conflict of interest in the provision of investment advice, sale, exchange or leasing of property, and the lending of money or other extension of credit.

Qualified Default Investment Alternative. An investment option, such as a lifecycle or balanced fund, that an employer may use for automatic enrollment of employees in a qualified plan. By using a QDIA instead of the traditional money market or stable value fund for initial plan contributions, the employer is allowed a safe harbor from investment liability under the PPA, even though the plan participants' account balances may be invested in a less conservative option.

Registered investment adviser. A professional fiduciary as defined by the Investment Advisers Act of 1940 or equivalent state statutes and who is affiliated with a registered investment advisory firm. The term "investment adviser" is a common term used in reference to persons who hold out to the public as financial planners, wealth managers, trust officers, portfolio managers, and investment management consultants.

Registered representative. An individual who has affiliated with an NASD member firm or broker-dealer, and who typically holds a Series 6 or Series 7 license to execute securities transactions on behalf of the firm.

Safe harbor rules. A series of guidelines which, when the fiduciary adviser is in compliance, may limit his or her liabilities under ERISA and the Code.

Socially-targeted investment or socially responsible investment (SRI). An investment that is undertaken based upon social, rather than purely financial, guidelines.

Strategic asset allocation. The act of rebalancing an investment portfolio back to a predetermined mix of investments at specified time intervals (usually quarterly or annually) or when established tolerance bands are violated (typically ±5 percent).

Style drift. Style drift in a portfolio refers to the tendency of actively managed portfolios and actively managed mutual funds to deviate from their stated or expected investment style. This drift can occur gradually over time, as in the case of a "small-cap" manager buying larger and larger companies as their fund asset base grows, leading to deviations in the modeled portfolio return.

Tactical asset allocation. The so-called "first cousin" to market timing because it uses certain "indicators" to make adjustments in the proportions of a portfolio invested in several distinct asset classes—usually stocks, bonds, and cash.