White Paper

The Case for Using a CEFEX Investment Advisor in a US Retirement Plan

A retirement plan is a complex employee benefit. It plunges the employer into the investment management business, one for which it is generally ill-equipped. Further, the employer becomes cloaked with the mantle of "fiduciary", thereby assuming the highest duties of loyalty and care known to the law and requiring the employer to act as a "Prudent Expert". Employers who enter the world of "fiduciary" without expert help do so at their peril and at risk to their employees who count on their employer to provide the best opportunity for a secure retirement.

An employer will not lack for help. Retirement plan mandates are highly sought by investment firms of all kinds but from the get-go, the employer must undertake a deliberative due diligence process to identify the advisor who can best meet the needs of the retirement plan. Then, having made a selection, the employer must make a reasoned determination that the arrangement meets a statutory "reasonableness" test, the statute being ERISA – the Employee Retirement Income Security Act of 1974.

As fiduciaries, employers should engage an investment advisor who also acts in a fiduciary capacity, to ensure that the advisor acts in the plan's best interests and with due care. This is in contrast to an advisor whose loyalties may lie elsewhere, for example, with an affiliated financial institution. Recognizing that there is confusion in the marketplace regarding fiduciary responsibilities, the U.S. Department of Labor (DOL), which oversees retirement plans and ERISA enforcement, has sought to change the regulation which defines who is a fiduciary. The new regulation, proposed on April 9, 2016, would make a fiduciary of virtually anyone who renders investment advice to a retirement plan and receives compensation for it. This would mean that advisors registered under the Investment Advisers Act of 1940 (the 40 Act), who are implicitly held to a fiduciary standard of care, would be joined by securities representatives of broker/dealers, otherwise subject to a "suitability" standard, a lesser standard of care. The new regulation is not yet in effect and its future is uncertain. However, the regulation raises the question of ***who can an employer trust*** when selecting an investment advisor?

Enter CEFEX – Centre For Fiduciary Excellence.

CEFEX is an independent rating and certification organization that works closely with the investment and fiduciary communities to provide comprehensive assessments that measure risk and trustworthiness of those engaged in managing an investment process.

CEFEX is a standards-based organization. Its assessment process is based on the international standard, ISO 19011: Guideline for quality management system auditing.

Assessments are thus evidence-based and typically include document review, client file sampling, on-site visits, interviews with senior representatives at the firm, and analysis of the firm's investment selection and monitoring methodology. Assessments are conducted by CEFEX Analysts who must have at least 10 years of industry experience and hold the Accredited Investment Fiduciary Analyst ® designation. Once completed, assessments are subject to review by the CEFEX Registration Committee, comprised of industry experts.

The CEFEX certification standards are organized according to a four-step management process. The steps are analogous to the global ISO 9000 Quality Management System standard, which emphasizes continual improvement in a decision-making process.

The quality management system standard applied to CEFEX assessment of investment advisors, meaning the "benchmark" against which an investment advisor's process is assessed, is described in the *"Prudent Practices for Investment Advisors"*[1] developed by the Center for Fiduciary Studies and written by Fi360.

There are 21 Prudent Practices and each is accompanied by associated criteria. Together, they comprise a Global Fiduciary Standard of Excellence. An investment advisor who successfully undergoes a CEFEX assessment receives certification of its conformity with this standard. This certification represents independent verification that the advisor meets the industry's highest standards and is worthy of public trust. Note that certification is currently available only to those advisors who are registered under the 40 Act or state equivalent.

Accordingly, an employer who chooses a CEFEX-certified advisor can be satisfied that comprehensive due diligence has already been undertaken by an independent expert third party. Selecting a CEFEX advisor helps satisfy the employer's obligation under ERISA to conduct due diligence upon selection of the advisor and on a continuing basis. Of course, CEFEX assessment, like any audit, is a "snapshot" and represents an observation at a point in time. So, at point of engagement, a prudent employer will ensure that an advisor is in good standing with CEFEX.

The Prudent Practices are substantiated by case law, statutes (such as ERISA), regulations and regulatory guidance. In an era of anxiety over fiduciary breach liability and the risk of fiduciary breach litigation, the employer should know that the Prudent Practices have been recognized in U.S. judicial proceedings.

The U.S Supreme Court recently heard a fiduciary breach claim involving 401(k) plan, *Tibble v. Edison Int'l.* 135 S.Ct. 1823, 2105. The court had to decide whether a claim could proceed for a breach of the fiduciary duty to monitor investments selected more than 6 years earlier, barring any statutory limitations.

[1] Prudent Practices for Investment Advisors, Copyright® 2006 -2013 by fi360.

In this case, the alleged imprudence was that the plan sponsor investment committee selected retail class shares for the chosen funds rather than institutional class shares that were available and that would have reduced participants' investment expenses. Because the claim based on the initial selection was barred by the statute of limitations, the participants argued that a subsequent breach occurred when the plan fiduciaries failed to monitor the investments and to switch share classes.

Cambridge Fiduciary Services, Inc. ("Cambridge") filed an amicus brief with the court[2] in which it argued that in addition to prudently selecting investments, plan sponsors and their advisors must also routinely monitor the investments. Cambridge pointed out that the Prudent Practices command diligence in monitoring fees, investments and vendors. The Supreme Court subsequently ruled[3] that a trustee has a continuing duty to monitor and remove imprudent investments. The ruling thus provides further substantiation of the Prudent Practices.

In *Karolyn Kruger, M.D., et al. v. Novant Health Inc., et al.,* Case No. 1:14-CV-208, the parties reached a settlement of fiduciary breach claims in which the plaintiffs had alleged that Novant 401(k) Plan participants had been charged excessive investment and plan administration fees and that plan fiduciaries had engaged in fraud and concealment. The settlement called for adoption of remediation measures in order to confirm the management of the plan and its investments to a fiduciary standard of care. With the assistance of Cambridge, CEFEX supplied an opinion in the form of a declaration[4] in which CEFEX described the applicable Prudent Practices. The declaration was cited with approval by the judge in a subsequent order[5].

Similarly, in *Dennis Gordon et al., v. Mass Mutual Life Insurance Co., et al.,* Case No. 13-CV-30184-MAP, the parties reached a settlement of fiduciary breach claims in which the plaintiffs had alleged that participants were charged excessive investment fees, that Mass Mutual imprudently used its General Account as an investment option together with unreasonably priced and underperforming proprietary funds. As in the prior case, the settlement agreement established a number of remediation measures in order to confirm the management of the plan and its investments to a fiduciary standard of care. With the assistance of Cambridge, CEFEX provided a declaration[6] in which CEFEX described the applicable Prudent Practices.[7]. The settlement was approved at the same time.

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[2] See: http://www.americanbar.org/content/dam/aba/publications/supreme_court_preview/BriefsV4/13-550_amicus_pet_cfs.authcheckdam.pdf

[3] https://www.supremecourt.gov/opinions/14pdf/13-550_97be.pdf

[4] http://www.novant401ksettlement.com/wp-content/uploads/2016/07/Motion-for-Attorneys-Fees-Reimbursement-of-Expenses-and-Case-Contribution-Awards-for-Named-Plaintiffs.pdf

[5] http://www.novant401ksettlement.com/wp-content/uploads/2016/09/Order-Granting-Attorneys-Fees.pdf at page 9.

[6] http://www.massmutualretirementplansettlement.com/wp-content/uploads/2016/09/MM-Motion-for-Attorneys-Fees.pdf

[7] http://www.massmutualretirementplansettlement.com/wp-content/uploads/2016/11/Order-Granting-Attorneys-Fees.pdf

In summary, the prudent employer should hire an investment advisor as an expert to manage the investment process. The very act of selecting an expert is fiduciary in nature, requiring due diligence and a reasonable arrangement as a result. By engaging a CEFEX-certified investment advisor, an employer can be assured of two things (i) the advisor has undergone an independent assessment to a fiduciary standard of care; and (ii) the Prudent Practices used in that assessment will guide the investment process governing the employer's 401(k) plan. These Practices may be relied upon as well-founded and as receiving growing recognition by the courts.

This level of assurance serves to distinguish a CEFEX-certified advisor from an otherwise qualified peer and to improve the employer's fiduciary and litigation risk management. It should also foster greater confidence among retirement plan participants in their ability to achieve their retirement income goals.

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