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ERISA Advisory Council
2024 Advisory Council on Employee Welfare and Pension Benefit Plans
Qualified Default Investment Alternatives (QDIAs) - Start to Finish, Default to Payout

Statement by

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I appreciate the opportunity to be here today and for the Advisory Council's interest in QDIAs. My name is Michael Kreps, and I'm Chair of the Retirement Services Group at Groom Law Group. A large part of my practice is devoted to advising on the development of QDIAs and other in-plan investment options and, in particular, investments that incorporate lifetime income features.

My remarks will focus primarily on the work that has been done to try to integrate lifetime income into QDIAs. But before I begin in earnest, I do want to be clear that I am here on my own behalf and not on behalf of any particular client or my colleagues. Any views or opinions are mine alone.

When Congress first passed legislation to create "cash or deferred arrangements" – the original term for 401(k) plans – few people could have predicted that, over the course of a single generation, defined contribution (DC) plans would come to dominate the private retirement system. The first generation of DC plans were largely considered supplementary to pension plans, and they were not more than a tax-preferred way for people to save. However, over the years, DC plans have undergone a remarkable transformation as policymakers, employers, labor organizations, and financial institutions have worked to improve participant outcomes.

Today, more people are participating in DC plans than ever before thanks to the proliferation of automatic enrollment and efforts to expand coverage. DC plans have also become considerably more transparent, professionalized, and efficient. However, most of the systemic improvements have focused on helping participants accumulate assets and not on the distribution phase of the participant life cycle.

For example, the Pension Protection Act of 2006 (PPA) and DOL regulations helped pave the way for better participant outcomes by explicitly allowing plans to use automatic enrollment and putting some guardrails around the types of permissible default investments. But the PPA was primarily focused on improving savings rates – meaning, the accumulation phase – and it did not really tackle the decumulation phase.

Now, as the first generation of savers relying entirely on DC plans begins to retire, there is a growing recognition that many plan participants are at risk of outliving their savings. Social Security continues to provide people with a basic level of guaranteed income, but it is typically

not enough to ensure that people can maintain their standard of living when they retire, regardless of whether that retirement is voluntary or involuntary.

Fortunately, in the nearly two decades since PPA passed, there have been serious efforts to address plan decumulation by developing lifetime income options for DC plans. In fact, fiduciaries have access to more income options than ever before, so I thought it would be useful to walk through some of the common approaches available in the market today.

First, there are the non-guaranteed options. These are education focused programs that give people guidance about how to draw down their savings in a way that mitigates longevity risk. The programs can standalone or can actually be incorporated into a QDIA or other plan investment option.

Next, there are the guaranteed options. These are options that incorporate annuities to provide protection from longevity risk. They come in several flavors, and the terminology can vary, but you can divide the guaranteed options into categories based on the promises being made by the insurer.

One type of promise is the fixed annuity. Fixed annuities resemble a traditional pension benefit in that participants are guaranteed to receive a fixed payment for life. A participant retains control of their account and is subject to market experience until the time that the participant pays a premium to an insurer. At that point, the insurer becomes obligated to make periodic payments that generally do not change over time, though some fixed annuities have cost-of-living adjustments.

Another type of promise is the Guaranteed Lifetime Withdrawal Benefits or GLWB. GLWBs address longevity risk by guaranteeing periodic payments while allowing participants to retain some control over their accounts and benefit from gains. Participants pay insurance premiums on amounts invested, and in exchange, one or more insurers guarantee that the participants can take distributions from their accounts at prescribed rates, even if the participants draw down the full value of the accounts. Participants generally retain the right to withdraw amounts in excess of the prescribed rate at any time, though excess withdrawals generally result in guarantee reductions.

The third type of annuity promise is the Qualified Longevity Income Contract or QLAC. QLACs are a type of deferred annuity intended to protect participants against longevity risk while allowing participants to retain control over most of their savings. A portion of a participant’s account is paid as a premium to an insurer, and the insurer promises to make benefit payments at some point in late retirement (typically at age 80 or 85). Participants keep control of the remainder of their DC plan account and can invest it and draw it down as they see fit.

Importantly, these types of annuities can generally be offered as standalone benefits or integrated into a particular investment option, including a QDIA. For example, some fiduciaries incorporate lifetime income into their DC plans by allowing participants to elect to add guarantees – typically GLWBs – to a managed account that uses the investment options on the DC plan’s platform to construct portfolios for individual participants based on their age or retirement date.

A newer approach is to actually embed the annuities into a pooled fund like a collective investment trust (CIT). This can simplify administration, and it typically shifts some or all of the responsibility for annuity selection to the fund's manager or trustee.

One important thing I want to note is that different lifetime income options require different levels of participant engagement. Some options require participants to make decisions for themselves. For example, a participant may need to affirmatively opt into the lifetime income option or make decisions about when to start taking their benefit. However, many lifetime income options are intended to be QDIAs or default investments, and some incorporate features like automatic benefit initiation. Fiduciaries may want to consider what approach works best for their plan and participant population.

We have a limited amount of time today, so I have submitted the following three white papers to provide addition background information:

- *Is Your DC Plan Retirement Ready? Helping Participants Get To and Through Retirement* (link);

- *Guaranteeing a Secure Retirement: A Practical Guide for Selecting DC Plan Lifetime Income Options* (link); and

- *Collective Investment Trusts and Good Governance Considerations* (link).

As I hope I have made clear, lifetime income options come in a variety of flavors. Some lifetime income options simply provide guidance to participants in drawing down their balances while other options provide guarantees from insurance companies. As it stands today, fiduciaries have the tools necessary to improve outcomes for participants by creating DC plans that focus on both accumulation and decumulation.

APPENDIX A

GROOM LAW GROUP

Guaranteeing a Secure Retirement

A Practical Guide for Selecting DC Plan Lifetime Income Options

February 1, 2022

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Executive Summary

- More and more employers are adding lifetime income investment options to their DC plans.
- A plan fiduciary has a duty to prudently select and monitor a lifetime income investment, just as they would with any plan investment.
- The SECURE Act of 2019 sought to make it easier to offer DC plan lifetime income options by creating a fiduciary safe harbor for these investments.
- A lifetime income investment can be used as the default investment for a DC plan, and the investment can qualify as a QDIA, provided certain regulatory conditions are met.

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Michael Kreps is a principal at Groom and Co-Chair of the firm's Retirement Services Practice Group. He specializes in benefit plan governance, administration, investments, funding, and restructuring. Michael previously served as Senior Pension Counsel to the Senate Committee on Health, Education, Labor & Pensions. He is external general counsel for the Committee on Investment of Employee Benefit Assets (CIEBA) and on the Executive Committee of the Defined Contribution Institutional Investment Association (DCIIA).

About Groom Law Group

Groom Law Group solves complicated legal issues for a variety of clients in finance, retirement, health care, and the public sector. Our exceptional level of service has earned us acclaim among clients, consistent top-tier rankings, and our industry's highest awards. With 45 years of experience practicing in Washington, D.C., Groom is widely recognized among the nation's leading benefits, health, and retirement law firms.

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Glossary

Annuity Selection Regulation. The term "Annuity Selection Regulation" refers to the DOL regulation addressing a fiduciary's duties with respect to the selection of an annuity distribution option for a DC plan. The regulations are codified at 29 CFR § 2550.404a-4.

DC plan. The term "DC plan" refers to a defined contribution individual account plan such as a 401(k) plan.

DOL. The term "DOL" refers to the U.S. Department of Labor, which has oversight of the fiduciary provisions of ERISA.

ERISA. The term "ERISA" refers to the Employee Retirement Income Security Act of 1974, as amended.

GRIC. The term "guaranteed retirement income contract" is defined in the SECURE Act Safe Harbor, which is codified at ERISA § 404(e)(6)(b).

Lifetime Income Option / Investment. For purposes of this paper, the terms "lifetime income option," "lifetime income investment," and "lifetime income investment option," which are used interchangeably, refer to investment options offered to participants in DC plans that provide insurer-backed guarantees to support the payment of benefit distributions in retirement.

GLWB. The term "GLWB" refers to guaranteed lifetime withdrawal benefit, which is generally a feature of, or rider to, an annuity contract guaranteeing that, when a participant depletes his or her DC plan account balance, an insurance company will continue to make payments to the participant for at least the life of the participant.

QDIA. The term "qualified default investment alternative" is defined in the QDIA Regulation.

QDIA Regulation. The term "QDIA Regulation" refers to the DOL regulation implementing ERISA section 404(c)(5), which is codified at 29 C.F.R. § 2550.404c-5.

SECURE Act. The "SECURE Act" is the Setting Every Community Up For Retirement Enhancement Act of 2019 (Pub. L. 116-94).

SECURE Act Safe Harbor. The term "SECURE Act Safe Harbor" refers to the fiduciary safe harbor for the selection of GRICs, which was included as section 209 of the SECURE Act and codified as ERISA § 404(e).

Tax Code. The term "Tax Code" refers to Internal Revenue Code of 1986, as amended.

Part I – Introduction

When Congress first passed legislation to create "cash or deferred arrangements" – the original term for 401(k) plans – few people could have predicted that, over the course of a single generation, DC plans would come to dominate the private retirement system. The first generation of DC plans were largely considered supplementary to pension plans and were crude by today's standards. However, over the years, DC plans have undergone a remarkable transformation as policymakers, employers, and labor organizations have worked to improve outcomes for participants.

Today, more people are participating in DC plans than ever before thanks to the proliferation of automatic enrollment and efforts to expand coverage. DC plans have also become considerably more transparent, professionalized, and efficient. However, most of the systemic improvements have focused on helping participants accumulate assets and not on the distribution phase of the participant life cycle.

As the first generation of savers relying entirely on DC plans begins to retire, there is a growing recognition that many plan participants are at risk of outliving their savings. Although Social Security continues to provide people with a basic level of guaranteed income, it is typically not enough to ensure that people can maintain their standard of living when they retire, whether that retirement is voluntary or involuntary.

To address this concern, an increasing number of DC plan sponsors are considering adding lifetime income investment options to their DC plans. In some cases, sponsors are designating lifetime income options as their plans' default investment when they want to provide all participants with guaranteed income. Congress has also recognized the problem and tried to remove real or perceived barriers to offering in-plan lifetime income options by passing the SECURE Act. This has resulted in a blossoming of the number and type of lifetime income options available to plan sponsors and participants.

This paper is intended to provide plan sponsors and other fiduciaries with a practical guide to help in the selection of lifetime income investments. It first explains what it means to be a fiduciary and then discusses the fiduciary duties in the context of providing lifetime income options within DC plans. Although this paper primarily refers to ERISA and 401(k) plans, the general concepts and considerations apply equally to non-ERISA DC plans, including church, 457, and 403(b) plans.

We hope this paper is helpful to all DC plan fiduciaries, but it was not written to address the facts or circumstances of any particular plan sponsor or fiduciary. Therefore, it should not be construed as providing legal opinions, tax advice, or investment advice. Readers should consult their legal, tax, and investment advisers before making any decisions with respect to their plans.

Part II – Demystifying Fiduciary Status

Who is a fiduciary?

Fiduciary status carries a certain degree of mystique, due in no small part to the labyrinth of legal requirements applicable to DC plans, but this is unfortunate because acting as a fiduciary is neither as daunting nor as fraught as some make it out to be. At its core, being a fiduciary means acting with the highest degree of care when managing participants' retirement savings, including selecting the investment options available to them.

It is important to understand who acts as a DC plan fiduciary because fiduciaries have the legal responsibility and liability for the plan's administration and management. ERISA has different types of fiduciaries. Some people become fiduciaries just by holding certain position with respect to a plan (*e.g.*, plan administrators, named fiduciaries, investment managers, and trustees),[1] but many fiduciaries are "functional fiduciaries," meaning they become fiduciaries because of their actions (or inactions). In this regard, ERISA imposes fiduciary status on a person to the extent that he or she –

- Exercises discretionary authority or control with respect to the management of a plan;
- Exercises any authority or control respecting management or disposition of plan assets;
- Has discretionary authority or responsibility in the administration of the plan; or
- Provides investment advice for a direct or indirect fee with respect to money or property of the plan.[2]

DOL takes the position that those responsible for selecting DC plan investments – including any lifetime income options – are acting in a fiduciary capacity and are, therefore, subject to the fiduciary duties discussed below. However, it is important to note that a person is only a fiduciary to the extent that he or she exercises fiduciary authority (or provides fiduciary advice), and a fiduciary typically will only be liable under ERISA when performing fiduciary functions.[3]

What are a fiduciary's duties when selecting DC plan investments?

No particular investment is required or *per se* imprudent under ERISA.[4] Instead, ERISA provides fiduciaries a considerable amount of latitude in designing the investment programs for their DC plans but then imposes on them certain fiduciary duties. Specifically, fiduciaries are required to:

- Carry out their duties "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;"[5]

- Discharge their duties with respect to a plan "solely in the interest of the participants and beneficiaries;"[6] and

- Act for "the exclusive purpose of providing benefits and defraying reasonable expenses of administration."[7]

To satisfy these duties when making investment decisions, a fiduciary generally needs to engage in a prudent process.[8] This means giving appropriate consideration to the facts and circumstances that the fiduciary knows (or should know) are relevant to the particular investment and then acting accordingly.[9] Every fiduciary's process varies, but the process generally involves –

- Gathering relevant information;

- Considering available courses of action;

- Consulting experts when necessary or helpful; and

- Making a reasoned decision based on all relevant facts and circumstances.

"The prudence requirement is flexible…," and there is no one-size-fits-all process.[10] However, it is important to have a process in place and to follow it. It is equally important to document the process so that the fiduciary is able to establish that he or she complied with ERISA in the event a decision is ever questioned.

Do fiduciaries have an ongoing duty to monitor plan investments?

It is well established that fiduciaries have an ongoing duty to monitor plan investments under ERISA.[11] For example, the Supreme Court has recognized that ERISA imposes on fiduciaries who select investment options for 401(k) plans a continuing duty to monitor the selections and remove imprudent investment options.[12] A fiduciary can establish that he or she has satisfied this monitoring obligation by engaging in a prudent process, which is often similar to, or a streamlined version of, the original selection process.

Is a fiduciary responsible for participants' investment decisions?

Fiduciaries generally are not liable under ERISA for any losses resulting from the investment decisions of participants or beneficiaries in DC plans that allow participants to direct their own investments, provided the plan meets certain requirements.[13] Specifically, ERISA states that when a participant or beneficiary exercises control over the assets of his or her account in a DC plan "no person who is otherwise a fiduciary shall be liable under this part for any loss, or by reason of any breach, which results from such participant's or beneficiary's exercise of control…."[14] The statute goes on to list a number of requirements that must be satisfied in order

to rely upon the fiduciary relief, and DOL supplemented these requirements with its own regulation.[15]

In 2006, Congress passed legislation intended to increase retirement plan participation by, among other things, expanding this relief to situations in which a fiduciary exercises its own discretion to select a default investment for participants who have not made an investment election (*e.g.*, automatically enrolled participants). The law provided that a fiduciary who selects a default investment for a DC plan will not be liable for losses that result from the investment of the participant's account balance, provided certain conditions are met.

The most important condition is that the investment qualify as a QDIA under DOL's QDIA Regulation.[16] Although there are a number of technical requirements, the QDIA Regulation generally permits fiduciaries to use three types of QDIAs – target date (or life cycle) funds, managed accounts, and balanced funds. Target date funds are the most widely used type of QDIAs, but fiduciaries have increasingly used managed accounts as a way to replicate the simplicity of target date funds while incorporating features unique to the participant, including customized glide paths and the investment in lifetime income guarantees.

Can a plan sponsor "outsource" his or her fiduciary duties?

ERISA allows the named fiduciary of a DC plan to appoint an investment manager to manage some or all of the plan's assets, and the courts and DOL have recognized that a named fiduciary is not liable for the acts of a properly appointed investment manager unless the named fiduciary participated in, enabled, or failed to remedy the manager's breach.[17] To be an investment manager under ERISA, one must –

- Have the power to manage, acquire, or dispose of any asset of a plan;
- Be either a registered investment adviser, a bank, or an insurance company; and
- Acknowledge in writing that he or she is a fiduciary with respect to the plan.[18]

Importantly, the plan's named fiduciary is generally responsible for selecting and monitoring any appointed investment managers.

Part III – Considering Lifetime Income Options

What special fiduciary considerations are there when selecting a lifetime income option?

The selection of a lifetime income option is not fundamentally different from the selection of any DC plan investment option. A fiduciary should engage in and document a prudent decision-making process that gives appropriate consideration to the facts and circumstances that the fiduciary knows (or should know) are relevant to the particular investment and then act accordingly. That includes a careful evaluation of the costs and benefits of the investment. A fiduciary is not required to select the lowest cost investment, but the fiduciary must ensure that the benefits provided justify the costs.

What makes the process of selecting lifetime income investments unique is that the fiduciary will need to evaluate the guarantees being provided by the insurer(s). This requires an understanding of both the explicit and implicit costs of the annuity or annuities and how the underlying insurance contracts work, including the rights of policyholders. It also necessitates an evaluation of the insurer's financial wherewithal to make good on its payments obligations, which can span decades.

Fortunately, fiduciaries need not become experts in the finer points of insurance company operations and regulation as the SECURE Act Safe Harbor (discussed below) now provides a framework for evaluating an insurer's claims paying ability. The SECURE Act Safe Harbor and the DOL's Annuity Selection Regulation (discussed in the next section) provide a detailed roadmap for fiduciaries considering lifetime income investments.

What does DOL think fiduciaries should consider when evaluating lifetime income products?

At the direction of Congress, DOL issued the Annuity Selection Regulation in 2008 to provide the agency's views as to how DC plan fiduciaries should evaluate in-plan annuity providers. DOL had previously issued guidance generally applicable to both defined benefit and DC plans.[19] However, Congress determined that the fiduciary standards applicable to DC plans and defined benefit plans should not be the same.[20] Together with the SECURE Act Safe Harbor, the Annuity Selection Regulation provides a framework for evaluating the guarantees included as part of lifetime income options.

The Annuity Selection Regulation creates a fiduciary safe harbor for the selection of an annuity as a DC plan distribution option. To meet the terms of the safe harbor, a fiduciary must –

- Engage in an objective, thorough, and analytical search to select a provider;[21]
- Appropriately consider information sufficient to assess the ability of the annuity provider to make all future payments under the annuity contract;[22]

- Appropriately consider the cost (including fees and commissions) of the annuity contract in relation to the benefits and administrative services provided;[23]

- Appropriately conclude that, at the "time of selection" the annuity provider is financially able to make all future payments under the contract and that the cost of the contract is reasonable in relation to the benefits and services to be provided;[24] and

- If necessary, consult with appropriate expert(s) for purposes of compliance with the above provisions.[25]

For purposes of the fourth condition, the phrase "time of selection" is defined to mean either the time that the annuity provider -

- Is selected along with the contract for purposes of contemporaneously distributing benefits to a specific participant or beneficiary; or

- Is selected to provide annuity contracts at future dates to participants or beneficiaries, provided that the selecting fiduciary periodically reviews the continuing appropriateness of the conclusion that the provider is financially able to make all future payments under the contract and that the cost of the contract is reasonable in relation to the benefits and services provided, taking into account the conditions of the safe harbor.[26]

DOL indicated that it wanted to clarify that the safe harbor conditions applied only to the decision to purchase an annuity.[27]

While some plan fiduciaries and their advisers believed that the Annuity Selection Regulation provided sufficient guidance for purposes of evaluating lifetime income options, others were not as comfortable relying solely on this guidance from DOL in large part because it was difficult for a plan fiduciary to evaluate an insurance company's claims-paying ability and creditworthiness. To address this concern (and others), Congress created the SECURE Act Safe Harbor in 2019.

How does the SECURE Act Safe Harbor help fiduciaries?

The SECURE Act Safe Harbor is a statutory safe harbor for a fiduciary's selection of certain lifetime income options for DC plans. The purpose of the law is to "…provide[] certainty for plan sponsors in the selection of lifetime income providers…" and, thus, "eliminate[] a roadblock to offering lifetime income benefit options under a [DC] plan."[28]

The SECURE Act Safe Harbor provides fiduciary relief for the selection of a "guaranteed retirement income contract" or GRIC on behalf of a DC plan. A GRIC is "an annuity contract for a fixed term or a contract (or provision or feature thereof) which provides guaranteed benefits annually (or more frequently) for at least the remainder of the life of the participant or the joint lives of the participant and the participant's designated beneficiary as part of an individual account plan." This broad definition covers a number of different types of lifetime income products, including those that

provide for distribution payments to participants and those that provide for the accumulation of retirement income within the plan. Most lifetime income products currently available qualify as GRICs.

One key purpose of the SECURE Act Safe Harbor was to build on and clarify certain aspects of the Annuity Selection Regulation (discussed above). For example, the SECURE Act Safe Harbor adopts modified versions of the conditions of the Annuity Selection Regulation, dispenses with certain others, and most importantly, facilitates satisfaction of conditions related to assessing the insurer's financial strength by deeming those conditions to have been met where the insurer delivers certain written representations to the selecting fiduciary.

What does a fiduciary have to do to comply with the terms of the SECURE Act Safe Harbor?

To meet the terms of the SECURE Act Safe Harbor, a fiduciary must engage in an objective, thorough, and analytical search for the purpose of identifying insurers and conclude that –

- At the time of the selection, the insurer is financially capable of satisfying its obligations under the contract; and
- The relative cost of the contract is reasonable taking into consideration the benefits, features, and services provided under the contract.

With respect to the first requirement, a fiduciary is deemed to have satisfied his or her obligations for evaluating the adequacy of the insurer's financial capabilities if the fiduciary receives a specified set of written representations from the insurer (provided that, after receiving those representations, the fiduciary has not received notice of any change in the insurer's circumstances or other information which would cause it to question the representations provided). Specifically, the insurer must represent that –

- It is licensed to offer GRICs;
- At the time of selection and for each of the immediately preceding seven plan years, the insurer (i) operates and has operated under a certificate of authority from the insurance commissioner of its domiciliary state that has not been revoked or suspended; (ii) has filed audited financial statements in accordance with the laws of its domiciliary state; (iii) maintains and has maintained reserves which satisfy all the statutory requirements of all states in which the insurer does business; and (iv) is not operating under an order of suspension, rehabilitation, or liquidation;
- The insurer undergoes, at least every five years, a financial examination by the insurance commissioner of its domiciliary state; and

- The insurer will notify the fiduciary of any change in circumstances after providing the above representations that would preclude the insurer from making such representations at the time of issuance of the contract.

Similar to the Annuity Selection Regulation, the "time of selection" under the SECURE Act Safe Harbor means the time that the annuity provider and contract are selected for distribution of benefits to a specific participant or beneficiary or the time that the annuity provider is selected to provide benefits at future dates to participants or beneficiaries, provided that the selecting fiduciary "periodically reviews" the continuing appropriateness of its conclusions regarding the financial capability of the insurer. A fiduciary is deemed to perform a periodic review if it receives the written representation described above from the insurer on an annual basis, unless it receives the notice of a change in circumstances (described above) or it becomes aware of facts that would cause the fiduciary to question the insurer's representations.

As for the requirement that a fiduciary evaluate the reasonableness of the GRIC's costs, presumably this is a requirement familiar to most fiduciaries as it is similar to the cost/benefit analysis conducted for all investment decisions. However, for the avoidance of doubt, the SECURE Act Safe Harbor makes it explicit that a fiduciary is not required to select the lowest cost GRIC. Rather, a fiduciary may consider the value of the GRIC, including the features and benefits of the contract and the attributes of the insurer.

Can sponsors engage investment managers to select lifetime income investments, annuities, and/or insurers?

Plan fiduciaries sometimes engage third parties to assist with the evaluation and selection of lifetime income investments, the insurer(s) providing the guarantees, or both. This can be beneficial where a fiduciary lacks the expertise to evaluate some or all of the aspects of a particular lifetime income investment options. Often fiduciaries engage a third party to provide non-fiduciary information or investment advice.

Fiduciaries who want an additional layer of protection can appoint an investment manager to manage some or all of the lifetime income product.[29] For example, a plan fiduciary could retain responsibility for selecting a target date fund (or setting the glide path of a managed account) while engaging an investment manager to evaluate insurers to provide a GLWB feature.

Can a default investment with lifetime income features be a QDIA?

To qualify as a QDIA, an investment must satisfy the conditions of the QDIA Regulation, which relate to, among other things, investment strategy, management, and liquidity. A lifetime income investment can qualify as a QDIA, provided it meets the regulatory conditions. In fact, the QDIA Regulation confirms that an investment option intended to be a QDIA may be an insurance product or contain features of an insured product.

The QDIA regulations explicitly state that an investment alternative *shall not* fail to constitute a QDIA –

> "*solely because the product or portfolio is offered through variable annuity or similar contracts or through common or collective trust funds or pooled investment funds and without regard to whether such contracts or funds provide annuity purchase rights, investment guarantees, death benefit guarantees or other features ancillary to the investment fund product or model portfolio*."[30]

In the preamble to the QDIA Regulation, DOL further stated that "it is the view of [DOL] that the availability of annuity purchase rights, death benefit guarantees, investment guarantees or other features common to variable annuity contracts will not themselves affect the status of a fund, product or portfolio as a [QDIA] when the conditions of the regulation are satisfied."[31] More recently, DOL issued an Information Letter stating that "[t]he use of unallocated deferred annuity contracts as fixed income investments" would not cause the funds to fail to meet the requirements to be a target date fund under the QDIA Regulation.[32]

Because of this authority, a number of plans currently use default investments with lifetime income features. These lifetime income features often utilize GLWBs and other types of deferred annuities to ensure that the investment meets the liquidity requirements under the QDIA Regulation.

We note that DOL has recognized that the QDIA Regulation is merely a safe harbor and, therefore, not the sole avenue for a fiduciary to satisfy his or her duties under ERISA.[33] In this regard, DOL provided the following guidance for a fiduciary selecting a lifetime income investment:

> "*[I]t would be important to evaluate the demographics of the plan and make a considered decision about how the characteristics of the investment alternative align with the needs of plan participants and beneficiaries taking into account, among other things, the nature and duration of the liquidity restrictions, the level of the guarantees of principal and minimum interest rates, any opportunities for the guaranteed minimum interest rates to be supplemented with additional credited amounts, as well as the expected lifetime income to be provided in retirement.*"[34]

DOL further opined that a fiduciary should also consider "whether the costs (including fees and investment expenses) associated with the investment alternative are reasonable in relation to the benefits and administrative services to be provided" and "what additional notice should be provided to participants of the liquidity and transferability restrictions in advance of their becoming applicable as well as the need for more education for affected participants and beneficiaries regarding the features of the investment alternative."[35]

Part IV – Other SECURE Act Changes

A primary goal of the SECURE Act was to shift the DC plan system from one focused on wealth accumulation to one with an eye toward producing retirement income. To accomplish this, Congress created the SECURE Act Safe Harbor, discussed above. However, it also included provisions addressing the portability of lifetime income investment options and a new lifetime income disclosure provision.

How did the SECURE Act improve the portability of lifetime income investments?

Section 109 of the SECURE Act amended section 401(a) of the Tax Code by adding a new paragraph (38) enabling defined contribution plans to include provisions allowing, on or after the date that is 90 days prior to the date on which a lifetime income investment is no longer authorized to be held as an investment under the plan, either (i) "qualified distributions of a lifetime income investment," or (ii) "distributions of a lifetime income investment in the form of a qualified plan distribution annuity contract."[36] Substantially similar amendments were also made to Tax Code sections 403(b)(11), 403(b)(7) and 457(d)(1) for purposes of extending the same level of portability to tax deferred annuities and custody accounts, and to governmental deferred compensation plans, respectively. For purposes of the amended Tax Code provisions –

- A "*lifetime income investment*" is defined to mean – a plan investment option providing participants with election rights (i) which are not uniformly available with respect to other plan investment options (*i.e.*, election rights that are distinct to that particular option); and (ii) which relate to a lifetime income feature available through a contract or arrangement under the plan;

- A "*lifetime income feature*" is one which (i) guarantees a minimum level of income annually or more frequently for at least the remainder of the life of the participant or the joint lives of the participant and his or her designated beneficiary, or (ii) an annuity payable on behalf of the employee under which payments are made in substantially equal periodic payments over the life of the participant or the joint lives of the participant and his or her designated beneficiary;

- A "*qualified distribution*" is defined as a direct trustee-to-trustee transfer, as described in Code section 401(a)(31)(A) to an "eligible retirement plan" (as defined in Tax Code section 402(c)(8)(B)); and

- A "*qualified plan distribution annuity contract*" means an annuity contract purchased for a participant and distributed to the participant by a plan or contract described in Tax Code section 402(c)(8)(B)(iii)-(vi).[37]

Allowing plans to include lifetime income portability provisions largely solves what has, until recently, been a significant technical challenge to the use of in-plan lifetime income products.

Many such products have features that can only be supported by one or a few investment platform providers. Until the SECURE Act, plans that had adopted and allowed participants to invest in such a product faced a dilemma if they ever wished to move to a new recordkeeping platform that did not support the product. If the plan elected to surrender the lifetime income product for purposes of transitioning to the new platform, the lifetime income benefits associated with the product would typically be lost. In order for the plan to both maintain the accumulated lifetime income benefits and transition to a new recordkeeper, it would often need to "leave behind" its lifetime income product holding with the original recordkeeper. This would leave the plan with two recordkeepers – the original, for purposes of maintaining the lifetime income product, and the successor, for purposes of maintaining records of all other plan investments. Coordinating the two sets of records for purposes of administering the plan often proved difficult and unwieldy.

The SECURE Act's solution for this problem is to permit both in-service trustee-to-trustee transfers of participants' lifetime income product interests to other eligible plans, including IRAs, and the purchase of distributed annuities for purposes of preserving a participant's accumulated benefit, during the 90-day period preceding the plan's discontinuance of the product. Since most insurers that offer lifetime income products in the employer-sponsored plan market also make the same product available through a retail IRA vehicle, plan participants that have accumulated in-plan lifetime income guarantees will be positioned to readily preserve those features to a successor vehicle if the plan decides to terminate the original arrangement.

What else did the SECURE Act do to help participants understand the value of retirement income guarantees and lifetime income investments?

SECURE Act section 203 amended the pension benefit statement rules under ERISA section 105 to require that individual account plans add a "lifetime income disclosure" to at least one pension benefit statement furnished to participants during a 12-month period. This lifetime income disclosure requirement becomes applicable to pension benefit statements furnished more than 12 months following the later of DOL's issuance of (i) interim final rules, (ii) a model lifetime income disclosure, or (iii) assumptions used to convert total accrued benefits to lifetime income streams.

By way of background, ERISA section 105 requires administrators of individual account plans to furnish a quarterly benefit statement to participants and beneficiaries who have the right to direct the investment of their plan accounts, and annually to participants and beneficiaries who lack investment direction rights. The contents of such benefit statements are required to include (i) the total amount of benefits accrued; (ii) the portion of total accrued benefits that are nonforfeitable, if

any, or the earliest date on which accrued benefits will become nonforfeitable; and (iii) the value of each investment to which individual account assets are allocated. Benefit statements for self-directed plans must also contain certain explanations about the participant's plan investment rights, the importance of a well-balanced and diversified investment portfolio, and furnish notice of a DOL internet website providing information about investing. The SECURE Act added a new lifetime income disclosure content requirement.

The new lifetime income disclosure must express a participant's total accrued benefits as a "lifetime income stream" (*i.e.*, as the monthly payment amounts that a participant or beneficiary would receive if the account balance were applied to provide a lifetime income stream, based on assumptions to be specified in a future DOL rule.) Two sets of lifetime income stream illustrations are required. The first is a qualified joint and survivor lifetime income stream, based on the assumption that the participant has a spouse of equal age. The second lifetime income stream to be illustrated is a single life annuity.

As required by the statute, DOL has issued interim final rules implementing the lifetime income disclosure requirement.[38] The rules prescribe the assumptions plan administrators are to use when converting total accrued benefits into lifetime income stream illustrations. They also contain model disclosures. Although the interim final rules are effective, DOL has confirmed that the agency is working on permanent, final regulations.[39]

Importantly, plan fiduciaries, plan sponsors and all other persons are relieved from any liability under the fiduciary responsibility provisions of ERISA (*i.e.*, Title I) for providing lifetime income disclosures to participants so long as the disclosures are based upon the assumptions and rules specified by DOL and include the explanations contained in DOL's model lifetime include disclosure.[40]

Endnotes

[1] 29 C.F.R. § 2509.75–8 ("[S]ome offices or positions of an employee benefit plan by their very nature require persons who hold them to perform one or more of the functions described in section 3(21)(A) [of ERISA]. For example, a plan administrator or a trustee of a plan must, be [sic] the very nature of his position, have 'discretionary responsibility in the administration of the plan'… Persons who hold such positions will therefore be fiduciaries.")

[2] ERISA § 3(21)

[3] ERISA § 3(21)(A); 29 C.F.R. § 75-8, at D-4; *Daniels v. National Employee Benefit Servs., Inc.*, 858 F. Supp. 684, 690 (N.D. Ohio 1994) (individual and insurance consulting firm qualified as fiduciary to plans with respect to investment of plan assets); *Johnson v. Georgia Pacific Corp.*, 19 F.3d 1184, 1199 (7th Cir. 1994) (for purposes of ERISA, a person is a fiduciary only with respect to those aspects of the plan over which he exercises authority or control); *Schulist v. Blue Cross of Iowa*, 717 F.2d 1127, 1130–32 (7th Cir. 1983) (insurer not a fiduciary in determining its compensation though a fiduciary in deciding benefit claims); *Beddall v. State Street Bank & Trust Co.*, 137 F.3d 12 (1st Cir. 1998) ("fiduciary status is not an all or nothing proposition"); *Moench v. Robertson*, 62 F.3d 553, 561 (3rd Cir.1995), *cert. denied*, 516 U.S. 1115 (1996) (fiduciary status under ERISA is not "all or nothing" concept); *Sommers Drug Stores Co. Employee Profit Sharing Trust v. Corrigan Enters., Inc.*, 793 F.2d 1456 (5th Cir. 1986), *cert. denied*, 479 US 1089 (1987) (trustee's authority in other matters did not make them fiduciaries with respect to matters over which they had no authority); *Arakelian v. National W. Life Ins. Co.*, 680 F. Supp. 400 (D.D.C. 1987) (ERISA ties fiduciary status of an entity to its responsibilities under the plan).

[4] Preamble to ERISA § 404 Regulation, 44 Fed. Reg. 37,221, 37,225 (June 26, 1979).

[5] ERISA § 404(a).

[6] ERISA § 404(a)(1)(A).

[7] *Id*.

[8] *See, e.g., Donovan v. Mazzola*, 716 F.2d 1226, 1232 (9th Cir. 1983), cert. denied, 464 U.S. 1040 (1984) (prudence involves an examination of whether the trustees "employed the appropriate methods to investigate the merits of the investment and to structure the investment"); *Donovan v. Walton*, 609 F.Supp, 1221, 1238 (S.D. Fla. 1985), *aff'd sub nom., Brock v. Walton*, 794 F.2d 586 (11th Cir. 1986); *Eyler v. Comm'r of Internal Revenue*, 88 F.3d 445, 454 (7th Cir. 1996); *DiFelice v. U.S. Airways, Inc.*, 497 F.3d 410, 420 (4th Cir. 2007).

[9] 29 C.F.R. § 2550.404a1(b)(1).

[10] *In re Unisys Sav. Plan Litig.*, 74 F.3d 420, 434–35 (3d Cir. 1996).

[11] *See, e.g., Tibble v. Edison Int'l*, 133 S.Ct. 1823 (2015).

[12] *Tibble*, 133 S.Ct. 1823. *See also* DOL Fact Sheet: Target Date Retirement Funds-Tips for ERISA Plan Fiduciaries (Feb. 2013).

[13] ERISA § 404(c)(1).

[14] ERISA § 404(c)(1).

[15] ERISA §§ 404(c)(2) - (4); 29 C.F.R. § 2550.404c-1-4.

[16] 29 C.F.R § 2550.404c–5.

[17] *See, e.g., Harris Bank and Trust v. Saloman Bros.*, 17 EBC 1390 (N.D. Ill. 1993).

[18] ERISA § 3(38).

[19] Interpretative Bulletin 95-1, 29 CFR § 2509.95-1.

[20] Pension Protection Act of 2006 § 625.

[21] 29 CFR § 2550.404a-4(b)(1).

[22] 29 CFR § 2550.404a-4(b)(2).

[23] 29 CFR § 2550.404a-4(b)(3).

[24] 29 CFR § 2550.404a-4(b)(4).

[25] 29 CFR § 2550.404a-4(b)(5).

[26] 29 CFR § 2550.404a-4(c).

[27] *Id*.

[28] The Setting Every Community Up For Retirement Enhancement Act of 2019, Pub. L. 116-94, §§ 101-404, 133 Stat. 3137-3180 (page 4 of section-by-section summary of Richard E. Neal, Chairman, H. Comm. on Ways and Means).

[29] ERISA § 402(c)(3).

[30] 29 C.F.R. § 2550.404c-5(e)(4)(vi).

[31] 72 Fed. Reg. at 60461.

[32] DOL Info Ltr. to M. Iwry (Oct. 23, 2014).

[33] DOL Info. Ltr. to C. Spence (Dec. 22, 2016)(stating that “[t]he use of unallocated deferred annuity contracts as fixed income investments” would not cause the funds to fail to be a target date fund under the QDIA regulations).

[34] *Id*.

[35] *Id*.

[36] A conforming amendment was also made to Code section 401(k)(2), pertaining to qualified plans with cash or deferred arrangements.

[37] Sub-paragraphs (iii) through (vi) of Tax Code section 402(c)(8) describe, respectively, section 401(a) qualified trusts, section 403(a) annuity plans, section 457(b) governmental plans, and section 403(b) annuity contracts.

[38] 85 Fed. Reg. 59132 (Sept. 18, 2020).

[39] DOL, Temporary Implementing FAQs: Pension Benefit Statements – Lifetime Income Illustrations Interim Final Rule (July 26, 2021).

[40] Note that this liability relief applies irrespective of whether the lifetime income stream that is illustrated is required to be provided as part of the participant benefit statement. Hence, the same protections would be available where plan fiduciaries and others providing lifetime income disclosures more frequently than annually or outside of the pension benefit statement, so long as they are computed using the assumptions prescribed by DOL and the explanations required by the model illustration.

APPENDIX B

GROOM LAW GROUP

Is Your DC Plan Retirement Ready?

Helping Participants Get To And Through Retirement

May 20, 2024

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Executive Summary

- Participating in Defined Contribution ("DC") plans such as 401(k), 457, and 403(b) plans is the primary way most people save for retirement, so it is important for DC plans to be designed with a focus on participant outcomes. **A well-designed plan can provide participants with an effective means of not only accumulating assets but also generating income in retirement.**

- Incorporating lifetime income options into a DC plan can help fiduciaries improve participant outcomes. **Fiduciaries have access to more lifetime income options than ever before**, and they have the ability to design lifetime income programs that both achieve the desired outcomes for participants and mitigate fiduciary risk.

- Being a fiduciary is about more than just avoiding lawsuits—it is about improving participant outcomes. Lifetime income options can help participants convert their savings into retirement income, and **a fiduciary's selection of a lifetime income option is not fundamentally different from the selection of any other DC plan investment**. The primary difference is that many lifetime income options come with guarantees from insurers that need to be evaluated.

- Fiduciaries have a number of tools at their disposal to mitigate risk, including delegating responsibility to investment managers or trustees and relying on the growing body of regulatory guidance. Many lifetime income options incorporate these tools into the product design, and **fiduciaries should understand how design choices impact overall legal risk**.

- **Lifetime income options come in a variety of flavors, and fiduciaries can determine which approach will result in the best outcomes for participants.** Some lifetime income options simply provide guidance to participants in drawing down their balances while other options provide guarantees backed by state-licensed life insurance companies. Different options require different levels of participant engagement with some requiring participants to make decisions for themselves and others using a more "do it for me" approach.

- Providers have taken a number of different approaches to designing guaranteed lifetime income options, and now, there are options that can accommodate fiduciaries' preferences and risk tolerances while also achieving optimal participant outcomes.

- See page 13 for a chart summarizing some of the key issues for plan fiduciaries considering the incorporation of lifetime income options into their DC plans.

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About Groom

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Focus on Retirement Income

Participating in DC plans such as 401(k), 457, and 403(b) plans is the primary way most people save for retirement, and there is considerable sponsor and participant interest in making DC plans more effective at their primary goal: providing income in retirement. In the past, this could seem like a daunting challenge, but today, there are more options than ever before, and fiduciaries have the ability to design a lifetime income program that both achieves the desired outcomes for participants and mitigates fiduciary risk.

Over the course of a single generation, DC plans have evolved from being supplemental savings programs to becoming the primary – and typically the only – retirement plan for most employees. As employees and retirees have come to rely more and more on DC plans, sponsors and policymakers have made great strides to improve the DC system by increasing participation (*e.g.*, auto-enrollment), expanding access, improving transparency (*e.g.*, fee disclosure), and professionalizing management and administration. Now, there is a growing focus on providing opportunities to participants to not only save for retirement but to convert their savings into a reliable source of income in retirement.

It is understandably difficult for participants to make their DC plan savings last a lifetime, and even investors with substantial assets may not understand how to transform their portfolios into retirement income. Consequently, many participants are acutely aware that they are at a real risk of outliving their savings. Approximately half of participants are concerned about running out of money in retirement, and "85% of plan participants wish their employer's retirement plan had an option designed to help generate a stream of income in retirement." [1]

More than 80% of sponsors feel a strong sense of responsibility to help participants generate income in retirement, so it is not surprising that plan sponsors are increasingly considering products and features to help participants convert their savings into a reliable source of retirement income.[2] This can have important benefits for participants, including simplifying the overall retirement experience, reducing risk, and improving trading behaviors.[3] Adding lifetime income features to a plan may also help employers manage their workforces. For example, research indicates that "[i]ncreased participant satisfaction can help promote employee loyalty."[4]

For fiduciaries looking at lifetime income options, it is important to understand that the products and services available in the market today have evolved significantly from those available in the past. There are now options available to achieve almost every goal and accommodate most fiduciaries' risk tolerances. This paper provides background to help fiduciaries better understand their legal obligations when considering lifetime income options and the products and services available.

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Fiduciary Basics

Being a fiduciary is about more than just avoiding lawsuits. It is about improving participant outcomes. Lifetime income options can help participants convert their savings into retirement income, and a fiduciary's selection of a lifetime income option is not fundamentally different from the selection of any other DC plan investment. The primary difference is that many lifetime income options come with guarantees from insurers that need to be evaluated.

Under ERISA, a person generally becomes a fiduciary if he or she exercises discretion over the management or administration of a plan, including selecting plan investments. [5] Fiduciaries are required to –

- Carry out their duties "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;"
- Discharge their duties with respect to a plan "solely in the interest of the participants and beneficiaries;" and
- Act for "the exclusive purpose of providing benefits and defraying reasonable expenses of administration."[6]

To satisfy these duties, fiduciaries need to engage in a prudent process.[7] Although there is no one-size-fits-all process for fiduciaries, it is important, as applicable to the specific situation, to gather relevant information, consider available courses of actions, consult experts when necessary or helpful, and make reasoned decisions based on all relevant facts and circumstances that they know or should know.[8] It is equally important to document this process to create evidence of ERISA compliance in the event decisions are questioned.

Notably, ERISA provides fiduciaries considerable discretion in designing investment programs for their DC plans. For example, no particular investment is required or per se imprudent under ERISA.[9] Therefore, while a fiduciary is not required to select the lowest cost investment, the fiduciary must ensure that the benefits provided justify the costs.

A fiduciary's selection of a lifetime income option is not fundamentally different from the selection of any other DC plan investment. The primary difference is that many lifetime income options come with guarantees from insurers that need to be evaluated. This means that a fiduciary must understand the costs of the annuity or annuities and how the underlying insurance contracts work, including any rights of policyholders. In addition, fiduciaries may also evaluate the insurer's financial wherewithal to make good on its payment obligations, which may span decades.

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Mitigating Risk

Fiduciaries have a number of tools at their disposal to mitigate risk, including delegating responsibility to investment managers and relying on the growing body of regulatory guidance. Many lifetime income options incorporate these tools into the product design, and fiduciaries should understand how those design choices impact overall legal risk.

Investment Managers

ERISA allows the named fiduciary of a DC plan to appoint an investment manager to manage some or all of a DC plan's assets.[10] This feature of ERISA was intended to allow a fiduciary to delegate some or all of their responsibilities to a professional with relevant expertise, and a properly appointed investment manager can materially reduce a fiduciary's risk. Both courts and the Department of Labor ("DOL") have recognized that a named fiduciary is generally not liable for the acts of an investment manager unless the named fiduciary participated in, enabled, or failed to remedy the manager's breach.[11] While the plan's named fiduciary remains responsible for selecting and monitoring the investment manager, it is generally not responsible for the manager's day to day decisions.

Regulatory Guidance & Safe Harbors

Over the years, the Department of Labor and Congress have provided a fair amount of guidance to assist fiduciaries interested in incorporating lifetime income options into their DC plans. This guidance includes the following:

- ***DOL's Annuity Selection Regulation.*** DOL issued a regulation in 2008 to provide guidance to fiduciaries considering the addition of annuities in their DC plans. The regulation provides that fiduciaries satisfy their duty of prudence if they satisfy five conditions, including that fiduciaries engage in objective and thorough searches for providers and assess insurance companies' claims-paying ability.[12]

- ***The Secure Act Safe Harbor.*** The Secure Act of 2019 included a new fiduciary safe harbor to provide relief for a fiduciary's selection of annuities for DC plans. Notably, the safe harbor makes it explicit that a fiduciary is not required to select the lowest cost annuity and may consider the value of the annuity, including taking into consideration the features and benefits of the contract and the insurer's attributes. Specifically, the provision was intended to "eliminate[] . . . roadblock[s] to offering lifetime income benefit options."[13] Fiduciaries are deemed to have satisfied their duty of prudence if they engage in an objective, thorough, and analytical search for the purpose of identifying insurers and conclude that, among other things, the insurer is financially capable of satisfying its obligations under the contract (based on certain written

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representations by the insurer) and the relative cost is reasonable taking into consideration the benefits, features, and services provided under the contract.[14]

- ***The Default Investment Safe Harbor.*** In 2006, Congress created a safe harbor to limit liability for fiduciaries who invest accounts for participants without investment elections (*e.g.*, automatically enrolled participants) in certain types of default investments, referred to as qualified default investment alternatives ("QDIA"). DOL regulations specify the specific types of investments that qualify as QDIAs and certain other eligibility conditions (*e.g.*, investment strategy, management, and liquidity).[15] DOL guidance lends support for the position that investment options intended to be QDIAs may be insurance products or contain features of an insured product.

Other Expertise

Not every fiduciary is an expert in all subjects, so it is sometimes useful for a fiduciary to engage outside experts to supplement their knowledge. Advisors and consultants often help educate fiduciaries on the options available, plan optimization, and investment selection. Similarly, lawyers and other professionals can assist fiduciaries in developing, executing, and documenting a prudent decision-making process that, if necessary, can withstand scrutiny.

Highlight: Product Design

Many of the lifetime income options available on the market today have been designed to take advantage of one or more of these risk mitigation tools. For example, some products are structured to alleviate the plan's named fiduciary of the responsibility for selecting insurers and annuities by delegating those decisions to an investment manager or trustee. In fact, product design can be one of the most important drivers of risk. Fiduciaries should carefully consider three key questions:

- What types of decisions does the plan's fiduciary have the knowledge and experience to make?
- Does the product delegate any fiduciary responsibility to an investment manager?
- What investment responsibilities are left for the plan sponsor and fiduciary?

Refer to page 12 for additional discussion about the most common design options.

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Types of Lifetime Income Options

It is important for fiduciaries to understand the lifetime income options available as they come in different flavors. Some options provide guidance to participants in drawing down their savings while others provide income guarantees. Different options also require different levels of participant engagement with some requiring participants to make decisions for themselves and others using a more "do it for me" approach.

Sponsors, fiduciaries, and providers have developed a number of different approaches to helping people convert their savings into retirement income. The "non-insured" approaches are intended to assist participants with the drawdown of their savings to decrease (but not eliminate) the risk that participants outlive their savings. These approaches often come in the following two flavors:

- ***Drawdown Strategies.*** Some plans assist participants in drawing down their accounts in retirement by providing educational tools intended to decrease the risk that a person will outlive their savings (*i.e.,* longevity risk). For example, a participant may receive information about the percentage of one's account that can be withdrawn annually to minimize longevity risk. This approach – sometimes referred to as a "systemic withdrawal" – allows participants to retain full control over their accounts, which are subject to market gains and losses, and the benefit payments are not guaranteed.

  Example: Plan X provides Participant Z with educational materials discussing common strategies such as the 4% rule, which says people can generally take distributions equal to 4% of the value of their account upon retirement (indexed for inflation in subsequent years). This education guides Participant Z, but they are free to disregard the information. Participant Z remains responsible for managing their investments and is in complete control of their account.

- ***Managed Payout Funds.*** Managed payout funds are pooled investments or managed accounts that use a manager or advisor to make periodic payments in a manner intended to minimize longevity risk. The payment amount may be adjusted from time to time to reflect market experience, and the payments are not guaranteed. Managed payout funds generally seek to minimize investment risk and volatility. Participants retain full control over their account.

  Example: Participant Z invests their savings in Fund Y. Fund Y invests in a conservative portfolio. Every year, Fund Y sets a target distribution rate (e.g., 4% of the account). Fund Y then makes periodic distributions to Participant Z based on the target distribution rate. Participant Z can take additional distributions, and the value of their account can increase or decrease based on the performance of the underlying investments.

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The "insured" or "guaranteed" approaches to lifetime income are intended to eliminate the risk that participants outlive their savings by providing guaranteed payments for life through annuity contracts issued by a licensed life insurer. These approaches can generally be grouped into the following three categories:

- ***Fixed Annuities.*** Fixed annuities resemble a traditional pension benefit in that participants are guaranteed to receive a fixed payment for life. A participant retains control of his or her account and is subject to market experience until the time that the participant pays a premium to an insurer. At that point, the insurer becomes obligated to make periodic payments that generally do not change over time, though some fixed annuities have cost-of-living adjustments. Fixed annuities may allow the participant to liquidate the annuity before payments begin, but there may be charges or penalties. Many traditional fixed annuities do not permit cash-outs after the start of benefit payments.

  Example: Participant Z pays the balance of their account to an insurer upon retirement and, in exchange, receives a set monthly payment for the remainder of their life.

- ***Guaranteed Lifetime Withdrawal Benefits ("GLWBs").*** GLWBs and related products (*e.g.*, guaranteed minimum withdrawal benefits) address longevity risk by guaranteeing periodic payments while allowing participants to retain some control over their accounts and benefit from gains. Participants, through their plan accounts, pay insurance premiums on amounts invested, and in exchange, one or more insurers guarantee that the participants can take distributions from their account at prescribed rates, even if the participants draw down the full value of the account. The amount of the guaranteed distribution is usually based on the account's "high-water-mark," measured at specified times. The assets in the account remain invested, typically in a strategy managed by a third-party fiduciary, and market gains can cause a participant's high-water-mark to increase, thereby increasing the amount of the guaranteed distribution. Participants generally retain the right to withdraw amounts in excess of the prescribed rate at any time, though excess withdrawals generally result in guarantee reductions.

  Example: Participant Z invests in balanced portfolio and begins to pay premiums to one or more insurers at age 55. Upon retirement at age 65, Participant Z begins to withdraw an amount equal to a percentage of the highest value of their account. The account continues to be invested, and if the account ever runs out of assets, one or more insurers will continue to make the retirement income payments. Participant Z can take extra distributions if necessary, though this would decrease the guaranteed monthly payment.

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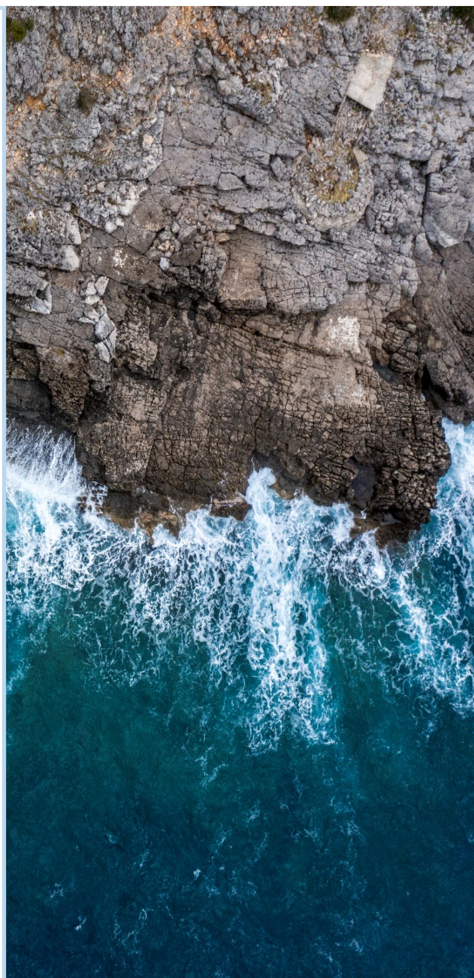
- ***Qualified Longevity Income Contracts ("QLACs").*** QLACs are a type of deferred annuity intended to protect participants against longevity risk while allowing participants to retain control over most of their savings. A portion of a participant's account is paid as a premium to an insurer, and the insurer promises to make benefit payments at some point in late retirement (typically at age 80 or 85). Participants keep control of the remainder of their DC plan account and can invest it and draw it down as they see fit. QLACs can be used in conjunction with a drawdown strategy or a managed payout fund.

  Example: Participant Z retires and pays a percentage of their account to an insurer in an exchange for a promise that the insurer will begin to make monthly payments in an fixed amount for the remainder of Participant Z's life once they turn 80. Before reaching 80, Participant Z is responsible for managing their own investments and drawdown.

Highlight: Understanding the Options

- **Drawdown strategies** are typically educational programs provided by the employer (or other third-party) to help participants understand how to spend their savings in retirement.
- **Managed payout funds** are usually standalone funds that make periodic payments to participants in retirement. The payments are not guaranteed.
- **Fixed annuities** make fixed, guaranteed payments to participants for life. They are typically (but not always) offered as standalone options selected by participants.
- **GLWBs** are typically added to an investment portfolio to guarantee that a participant can take distributions from their account for life while still providing participants with control over their savings.
- **QLACs** generally provide fixed, guaranteed payments beginning later in retirement age (*e.g.*, 80 years) and can be purchased as standalone investments or incorporated into an investment portfolio or fund.



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Overview of Lifetime Income Options

The chart below provides a summary of some of the most common lifetime income options. However, each product is unique, and some may provide features different from those outlined below.

	Non-Guaranteed Options		*Guaranteed Options*		
	Drawdown Strategies	Managed Payout	GLWB	Fixed Annuity	QLAC
Are benefit payments guaranteed?	No	No	Yes	Yes	Yes
Do participants benefit from investment gains?	Yes	Yes	Yes	No	No
Are participants insulated from market losses?	No	No	Yes	Yes	Yes
Is the benefit amount determined based on the value of an investment portfolio?	Yes	Yes	Yes	No	No
Can participants liquidate their account *before* payments start?	Yes	Yes	Yes	Yes	No
Can participants liquidate their account *after* payments start?	Yes	Yes	Yes	No	No
Can the option be embedded in a larger investment portfolio?	No	Yes	Yes	Yes	Yes

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Common Design Structures

Over the years, providers have taken a number of different approaches to designing guaranteed lifetime income options, and now, there are options that can accommodate fiduciaries' preferences and risk tolerances while also achieving optimal participant outcomes.

Standalone Annuities

Some DC plans make an annuity option available directly on the plan's investment lineup. These annuities can be either immediate (*e.g.*, a fixed annuity) or deferred (*e.g.*, a QLAC). The annuities and insurers are selected by a fiduciary for the plan, and the fiduciary is responsible for determining that the annuities are a prudent investment option. The fiduciary may engage an investment manager, adviser, or consultant to assist with the annuity selection and/or monitoring, though it is not required. Participants are generally responsible for deciding when to purchase the annuity and how much of their savings to annuitize.

Adding Guarantees to a Fund or Managed Account

Some fiduciaries incorporate lifetime income into their DC plans by allowing participants to elect to add guarantees – typically GLWBs – to a fund or strategy often already on the plan's investment lineup. This commonly, but not always, takes the form of a managed account that utilizes the investment options on the DC plan's platform to construct portfolios for individual participants based on their age and/or retirement date. The portfolios often resemble target date funds in that they become more conservative as the participant nears retirement. The investments, annuities, and glide path (if any) must be prudently selected by a fiduciary for the plan, and fiduciaries often engage investment managers to assist with some portion of the lifetime income program. This approach is often intended to qualify as a QDIA.

Target Date Funds with Embedded Guarantees and Other "Bundled" Funds

The newest type of lifetime income options are single funds that offer "bundled" asset management services and lifetime income guarantees. These funds typically offer GLWBs or QLACs and are structured as collective investment trusts ("CITs"), though they can take other forms. The funds often operate as target date funds, and if they are CITs, the trustee for the CIT is appointed as an investment manager and fiduciary for the investing DC plans. This means the trustee is primarily responsible for selecting the investments, setting the glide path (if any), and selecting the annuities. The plan's fiduciary remains responsible for determining whether the plan's overall investment in the fund is prudent. This approach is typically intended to qualify as a QDIA.

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Fiduciary Considerations

The chart below is intended to provide an overview of some (but not all) of the key issues for fiduciaries to consider when evaluating lifetime income options.

Issue	Why it Matters	Questions to Consider
Plan Goals	Fiduciaries are often most effective when they have a vision for their plan and understand the goals they hope to achieve, including participant outcomes. They can then implement their vision by engaging in prudent processes to, among other things, select plan investments to achieve the desired results.	• Is the DC plan the primary retirement plan for employees or supplemental to pension or other retirement programs? • What does the workforce need from the DC plan? • What are the desired outcomes for plan participants? • Can the plan be designed in a way that increases the likelihood that participants will make better decisions and have better outcomes?
Internal Expertise	Fiduciaries are not required to be experts on all subjects, but they are required to seek out relevant expertise to the extent necessary to make prudent decisions.	• Does the plan's investment fiduciary have experience with lifetime income options and/or annuities? • To what extent are external experts necessary to assist with a prudent process?
Guarantees	There are a variety of approaches to lifetime income, and each approach has its own unique benefits and risks. It is important that fiduciaries consider what approach works best for plan participants and is expected to have the best overall outcomes.	• What is the likelihood that participants using a lifetime income option will run out of money in retirement? • Are guarantees important for participant outcomes? • Would participants benefit from longevity risk protection?

Design & Structure	Guaranteed lifetime income options can be standalone annuities, annuities added onto existing investment options, or annuities embedded within a CIT or other pooled fund. Each approach has a different risk profile.	• What decisions do participants need to make and are they generally capable of making those decisions? • Is it beneficial to incorporate guarantees into a broader investment strategy? • Is the fiduciary capable of being the individual primarily responsible for investment and annuity selection or should core functions be delegated to an investment manager or incorporated into the product structure? • To what extent does product design help participants mitigate risk by, for example, providing downside protection or locking in future income payments? • Is there an opportunity for better outcomes through pooled approaches that can achieve economies of scale and/or spread risk?
Fees	Fiduciaries must always consider fees, but they are not required to select the lowest cost option. Instead, fiduciaries must ensure that the fees are reasonable in light of services being provided. This includes consideration of the types of fees charged as well as the impact those fees have on participant outcomes.	• What are the direct and indirect fees and how do they impact participant outcomes? • What benefits are derived from the lifetime income option and are the fees reasonable in light of those benefits? • How do those fees compare to similar products and services in the market? • What are the costs of incorporating a lifetime income benefit into an investment program or portfolio?
Administration	Fiduciaries will likely want to evaluate how particular lifetime income options integrate within the plan and determine whether they are supported by key	• How does the lifetime income option meet plan qualification requirements (*e.g.*, the required minimum distribution rules)? • Does the plan's recordkeeper support the lifetime income option? Are there any limitations?

	service providers (including plan recordkeepers). Options can also affect plan qualification requirements.	• How is the data used to administer the lifetime income shared between key plan service providers?
Investments	To the extent a lifetime income option incorporates an investment component, it is important that plan fiduciaries understand how the assets are invested and who is ultimately responsible for making investment decisions.	• Are participants exposed to the markets and to what extent? • Is the investment strategy age-appropriate? • Does the investment strategy help participants grow their savings over the course of their working lives or is the investment strategy overly conservative, resulting in lower growth? • What are the investments and is there a glide path or other strategy to adjust the asset mix over time? • Who is responsible for selecting the investments and is there an investment manager? • Are there restrictions on the investments (*e.g.*, limitations put in place by the insurer), and if so, how do those limitations affect outcomes for participants?
Guarantee Operation	Guaranteed lifetime income options come in a number of different forms, and the primary difference is how annuities are incorporated into the plan. Fiduciaries need to have a clear picture of how the guarantees operate and who makes key decisions. This will help fiduciaries determine the approach most appropriate for their plan and their participants.	• Do participants have the ability to make sound decisions about annuities, including when to annuitize and how much of their savings to annuitize? • Would participants benefit from having the guarantees embedded into a more comprehensive investment program that automates some or all of the annuity-related decisions? • How do the guarantees operate (*i.e.*, when do the guarantees apply and are there any limitations)?

		• Who determines the allocation of accounts to the annuity? • Is the lifetime income benefit calculated on the entire portfolio value or just on the premium amount? • How are the guarantees priced (*e.g.*, on a group basis with unisex pricing)?
Allocation of Fiduciary Responsibility	Some fiduciaries want to remain hands-on and manage all aspects of a lifetime income option while others prefer to delegate key functions to third parties. Either approach can work, but fiduciaries should make decisions about the allocation of fiduciary responsibility carefully and take into consideration their unique circumstances.	• To what extent is the fiduciary capable of making prudent decisions regarding the management and administration of a lifetime income option? • Does the fiduciary want to be responsible for decisions about the day-to-day operation of the lifetime income option? • Does the fiduciary want to be responsible for insurer selection or is it necessary or appropriate to delegate that function to a third party (*e.g.*, an investment manager)?
Participants' Role & Experience	As the DC system has developed over time, plans have begun to incorporate automatic features to simplify the participant experience and encourage better overall outcomes.	• To what extent do participants have to make affirmative choices and decisions? • Are participants more likely to have optimal outcomes with a "do it for me" approach (*e.g.*, one that incorporates auto features)? • Could the participants benefit from being automatically enrolled in a lifetime income option or do they need to opt in? • Is it appropriate to utilize a lifetime income option with automatic initiation of the benefits or should participants be required to take affirmative steps to begin receiving retirement income? • How are benefits communicated to participants over the course of their lives?

		• To what extent must the employer provide supplemental information? • Does the lifetime income option complement any existing retirement education programs?
Communications	Sponsors have to meet certain statutory reporting and disclosure obligations. It is important to understand what additional obligations come with a lifetime income option and what support is available.	• What disclosure obligations are there? • Are there model communications or does the provider communicate directly with participants? • Do participant communications align with key life events?
Liquidity	Liquidity is an important consideration because it can materially impact participants' ability to access their savings and that can affect participant behavior and outcomes.	• How important is liquidity to participant outcomes? • Are participants able to liquidate some or all of their accounts after investing in the lifetime income option or is the decision revocable? • Are there any penalties, fees, or other consequences of liquidating some or all of an account?
Portability	Fiduciaries will likely want to consider to what extent a lifetime income option is portable, meaning whether a participant can retain the benefit when they leave the plan or the plan can no longer support the option. Portability is an important consideration because it can have a direct impact on participants and it also can impact the ability of sponsors to change their plans.	• What options are available for participants to retain their benefits in the event they leave the plan? • What are the implications for the plan and participants if a fiduciary decides to stop offering the lifetime income option?

[1] Greenwald Research, Plan Participants Want Options That Generate Retirement Income in Their Workplace Retirement Plans (Jan. 12, 2022) (link).

[2] J.P. Morgan Asset Management, *Continued Progress Through Partnership: Expanding the Trend of Doing More for Participants* (2023) (link). *See also* Nationwide Retirement Institute, 2021 In-Plan Lifetime Income Survey (Sept. 10, 2021) (link).

[3] PGIM, *Stay the Course* (Feb. 2022) (link).

[4] EY, *Protected Retirement Income Solutions: What Plan Sponsors Need to Know About a New Generation of Offerings* (Feb. 22, 2024) (link).

[5] The rules applicable to fiduciaries are discussed in more detail in our Practical Guide for Selecting DC Plan Lifetime Income Options and our analysis of the Lifetime Income Provisions Under the SECURE Act.

[6] ERISA § 404(a).

[7] *See, e.g., Donovan v. Mazzola*, 716 F.2d 1226, 1232 (9th Cir. 1983), cert. denied, 464 U.S. 1040 (1984) (prudence involves an examination of whether the trustees "employed the appropriate methods to investigate the merits of the investment and to structure the investment"); *Donovan v. Walton*, 609 F.Supp, 1221, 1238 (S.D. Fla. 1985), *aff'd sub nom., Brock v. Walton*, 794 F.2d 586 (11th Cir. 1986); *Eyler v. Comm'r of Internal Revenue*, 88 F.3d 445, 454 (7th Cir. 1996); *DiFelice v. U.S. Airways, Inc.*, 497 F.3d 410, 420 (4th Cir. 2007).

[8] *In re Unisys Sav. Plan Litig.*, 74 F.3d 420, 434–35 (3d Cir. 1996).

[9] 44 Fed. Reg. 37221, 37225 (June 26, 1979).

[10] ERISA § 3(38)

[11] *See, e.g., Harris Bank and Trust v. Saloman Bros.*, 17 EBC 1390 (N.D. Ill. 1993).

[12] 29 CFR § 2550.404a-4.

[13] The Setting Every Community Up For Retirement Enhancement Act of 2019, Pub. L. 116-94, §§ 101-404, 133 Stat. 3137-3180 (page 4 of section-by-section summary of Richard E. Neal, Chairman, H. Comm. on Ways and Means).

[14] ERISA § 404(e)(6).

[15] 29 C.F.R. § 2550.404c-5.

GROOM

APPENDIX C

GREAT GRAY
TRUST COMPANY

Collective Investment Trusts and Good Governance Considerations

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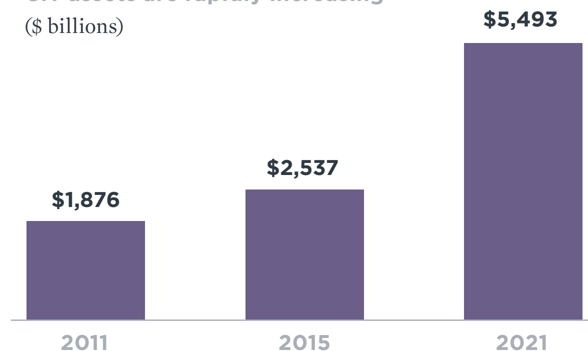
lll. Demonstrating Prudent Oversight Through Good CIT Governance

l. Introduction

Plan sponsors and other fiduciaries responsible for 401(k) plan investment menu construction, including their advisors, are demonstrating growing interest in adopting collective investment trusts (CITs) as plan investment options. There are several powerful market forces driving this trend. First, the investment strategies and related teams of investment professionals available to 401(k) plans through mutual fund complexes are becoming increasingly available through CIT structures. Second, the exemptions from registration under the federal securities laws available to CITs may afford them cost advantages relative to their mutual fund counterparts, because CITs can avoid the expenses associated with mutual fund registration; prospectus and annual report updating and mailing, and the like. Lastly, CITs are relatively flexible arrangements. CIT structures can implement new investment strategies and approaches quickly and easily. Accordingly, banks and trust companies that offer CIT products are able to respond to market demand for customized products quickly and nimbly—particularly in the evolving target date fund segment. With all of these advantages, it is unsurprising that CITs have attracted an ever-larger percentage of 401(k) plan assets over the past 20 years.[1]

CIT assets are rapidly increasing
($ billions)



Over 290% growth from 2011 to 2021

There is no assurance that any investment strategy will be successful. Source: The Cerulli Report, U.S. Defined Contribution Distribution, 2022.

Investments Are NOT Deposits • Are NOT FDIC Insured • Are NOT Insured By Any Federal Government

[1] In 2021, CIT target-date funds captured a 45% market share with $1.48 trillion assets vs. mutual fund target-date assets of $1.79 trillion assets. By comparison, in 2014, CIT assets of $154 billion accounted for an 18% market share compared to the mutual fund assets of $703 billion. Morningstar Direct. Pensions and Investments, Collective Investment Trust No Longer Just for the Big Dogs, July 18, 2022 (citing Morningstar Direct).

continued

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There is significant regulatory focus on banks and trust companies that offer CITs to ensure they maintain sound, coherent, procedures.

With increased interest from plan fiduciaries in CITs and the policies and procedures banks and trust companies use to govern their CIT offerings, factors are emerging that may warrant consideration by plan fiduciaries when making plan investment option decisions. As discussed below, modern CIT structures have been shaped by and reflect a triad of regulatory influences—arising, respectively, under the body of state and federal laws governing the exercise of trust powers by banking institutions; the federal securities laws; and the Employee Retirement Income Security Act (ERISA) of 1974, as amended.[2] Evident in each instance is a concentrated regulatory focus on the need for banks and trust companies that offer CITs to maintain sound, coherent, and well-implemented policies and procedures to assure that CITs are prudently administered and managed by the sponsoring institution. This paper uses the term "governance" to refer to the processes and procedures that banks and trust companies adopt for purposes of achieving these prudent CIT administration and management objectives.

Interest in good CIT governance is not limited to the community of regulators. Governance is also relevant to plan fiduciary decision-making. In this regard, a plan fiduciary's consideration of the quality of an institution's CIT governance practices would be consistent with undertaking a prudent evaluation of the institution's CIT offerings.

Below, we briefly explore relevant portions under each of the three legs of the regulatory triad referenced above. In particular, we examine the regulatory emphasis on the central role that good CIT governance—in the form of well-designed and implemented bank-maintained processes and procedures—plays in the ongoing management and operation of CITs. We also address and discuss how regulatory considerations inform CIT governance policies and may be reflected and implemented through good governance practices.

[2] The Internal Revenue Code (Code) has also exerted a strong influence on the development of CITs. Federal tax laws have largely focused on the types of arrangements eligible to participate in CITs as distinct from the governance processes and procedures a sponsoring financial institution utilizes to manage CITs.

continued

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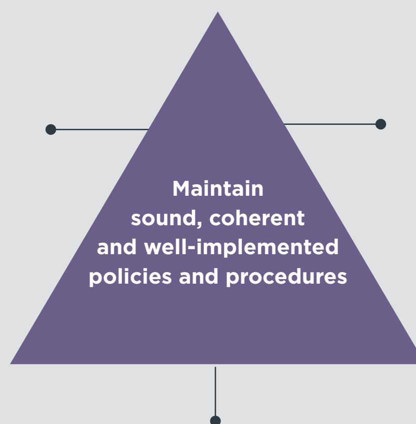
Triad of regulatory influences that shape CIT governance considerations

State and Federal Banking Laws

- Regulation 9 & OCC
- Prudent delegation and oversight
- Ongoing due diligence



The Federal Securities Laws

- CITs eligible for federal securities laws exemptions
- Must maintain clear governance practices
- Bank must maintain “substantial investment responsibility”

Employee Retirement Income Security Act of 1974

- ERISA fiduciary duties
- Duty to avoid prohibited transactions

State and Federal Banking Laws

Leg 1

II. The Triad of Regulatory Influences That Shape CIT Governance Considerations

A. The first leg of the triad – state and federal banking laws

CITs of the modern era evolved from common trust fund arrangements that state-chartered banking institutions developed during the 1920s.[3] It was during this period that a number of states first enacted legislation permitting state-chartered bank and trust companies to commingle funds of clients to whom they owed fiduciary responsibilities as a trustee (e.g., in connection with the administration of an estate).[4] These state law developments were reflected in changes at the federal level in 1936 when the Federal Reserve Board, which at that time regulated the exercise of fiduciary powers by national banks, adopted regulations permitting the use of common trust funds by nationally chartered banks, subject to the limitation that such funds be maintained only in connection with the investment of funds “held for true fiduciary purposes.”[5] The purpose of the restriction was to ensure that common trust funds maintained by national banks were used to advance economic and administrative efficiencies in the administration of fiduciary accounts, and not as vehicles for the investment of funds by the general public.[6]

In 1962, Congress transferred supervisory authority over the trust powers of national banks from the Federal Reserve Board to the Office of the Comptroller of the Currency (the OCC).[7] One year later, the OCC adopted a comprehensive new regulation addressing fiduciary activities of national banks, including the operation of pooled investment trusts—12 C.F.R. Part 9 (Reg. 9). Importantly, Reg. 9 did not limit the use of pooled trust fund products to the management of monies held for “true fiduciary purposes.”[8] This key development allowed for the emergence of modern CITs. At both the federal and state levels today, banking regulators generally

[3] W. Wade, Bank-Sponsored Collective Investment Funds: An Analysis of Applicable Federal Banking and Securities Laws, 35 Bus. Law. 361, 363 (1980).

[4] Id. Please also note: As used in this article, the word “bank” refers to both depository institutions regulated as such and to trust companies. Trust companies are business entities authorized to engage in the business of acting as a trustee and similar fiduciary and custodial activities. Although regulated as banking institutions, trust companies typically do not engage in the typical commercial banking functions of accepting general deposits and lending money. See, W. Wade, Bank-Sponsored Collective Investment Funds: Multi-Dimensional Regulation, First Edition, published by the American Bankers Association, (2015).

[5] Wade, 35 Bus. Law. 361,364.

[6] Id., citing 26 Fed. Res. Bull. 393 (1940).

[7] Id., at 365.

[8] Id.

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look to Reg. 9 and its principles as the prevailing regulatory standard for the oversight of CITs.[9]

While Reg. 9 is directly applicable only to nationally chartered banks and trust companies, the laws and regulations applicable to state-chartered institutions frequently subject CITs maintained by state-chartered entities to comply with Section 9.18 or compliance with similarly written state provisions.[10] The Federal Deposit Insurance Corporation (FDIC) recommends that "[e]ven where not required by law, the standards set forth in Section 9.18 should be followed by state nonmember banks as industry best-practices for all funds."[11]

Reg. 9 distinguishes between two types of pooled trust funds. Section 9.18(a) (1) describes a traditional common trust fund as: "A fund maintained by the bank, or by one or more affiliated banks, exclusively for the collective investment and reinvestment of money contributed to the fund by the bank, or by one or more affiliated banks, in its capacity as trustee, executor, administrator, guardian, or custodian under a uniform gifts to minors act." By contrast, the modern CIT that has emerged as a popular 401(k) plan investment vehicle is described in Section 9.18(a)(2) as: "A fund consisting solely of assets of retirement, pension, profit sharing, stock bonus or other trusts that are exempt from Federal income tax."

Reg. 9 enshrines a core regulatory principle applicable to CIT management that profoundly shapes CIT governance considerations: "A bank administering a collective investment fund shall have exclusive management thereof, except as a prudent person might delegate responsibilities to others."[12] The OCC explains that this notion of exclusive management, subject to the ability to prudently delegate, derives from the Restatement of Trusts' prudent investor rule.[13] In guidance, the OCC has drawn similarities between the prudent investor rule's allowance for prudent delegation and ERISA principles permitting investment fiduciaries to prudently delegate investment responsibilities.[14]

The OCC emphasizes that principles of prudence apply whenever a bank engages in determinations about whether and to whom CIT management authorities may be delegated

> "The trustee must act prudently in deciding whether, to whom, and in what manner to delegate fiduciary authority in the administration of a trust. The trustee should consider all relevant circumstances in connection with the delegation of investment functions, including the knowledge, skill, capabilities, and compensation of both the trustee and agent. Other circumstances to be considered include the size of the trust, the nature and complexity of the trust assets, and the particular goals of the investment strategy."[15]

The OCC has also indicated that the duty of prudence is an ongoing one that continues following a decision to delegate: "The trustee is under a duty to supervise any agents to whom investment responsibilities are delegated."[16] Consistent with that guidance, the OCC has indicated, for example, that the "exclusive management" requirement of Section 9.18(b)(2) is not met if the trustee simply accepts an

[9] See FDIC Trust Examination Manual, Section 7, Compliance- Pooled Investment Vehicles (Many states have promulgated laws regarding CIFs. Due primarily to the need to comply with federal securities and tax laws, state laws are generally similar to Regulation 9.18.).

[10] FDIC Trust Examination Manual, Section 7, Compliance- Pooled Investment Vehicles, Section 7.E.1.

[11] Id.

[12] C.F.R. § 9.18(b)(2) (emphasis added).

[13] See Comptroller's Handbook, Asset Management, Collective Investment Funds, Version 1.0 (May, 2014), at 43.

[14] See Comptroller's Handbook, Investment Management Services (Aug. 2001), at 120.

[15] Id.

[16] Id.

continued

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investor's direction as to the broker-dealer to be used to execute a CIT's trades.[17]

A national bank may use qualified personnel and facilities of affiliates to perform services related to the exercise of its trust powers; and it may, pursuant to a written agreement, purchase services related to the exercise of those powers from another bank or another third-party entity.[18] But the bank's CIT management activities remain subject to an overarching requirement—that they be managed by or under the direction of the bank's board of directors, even though the board may permissibly assign any function related to the exercise of fiduciary powers to a bank director, officer, employee, or committee.[19]

It has become increasingly commonplace for banks to engage the services of expert investment advisors—typically referred to as "subadvisors"—to render recommendations to the bank with respect to the investment and re-investment of CIT assets. As noted at the outset of this paper, part of the appeal of CITs to plan fiduciaries is that the strategies and the investment personnel utilized by CIT subadvisors often align with those of a counterpart, previously established, mutual fund offering. By adopting CITs, a plan may make those same strategies and investment personnel available to participants, but at a relatively lower level of expense. The activities of the CIT subadvisor, however, remain subject to the oversight and ultimate authority of the bank.

With respect to the use of subadvisors, a particular OCC concern is that banks not "rent their charters" to third-party registered investment advisors seeking to use the bank's status as a fiduciary to sponsor one or more funds on their behalf.[20] The OCC has emphasized that a bank's use of outside third parties to perform functions on its behalf does not diminish the responsibility of the bank's internal management team to ensure that those functions are performed in a safe and sound manner and in compliance with applicable laws.[21] The OCC expects a national bank relying upon third parties, including CIT subadvisors, to maintain risk management processes that are commensurate with the level of risk and complexity of the third-party relationship; with more comprehensive and rigorous oversight and management of third-party relationships that involve critical activities.[22] Accordingly, the OCC expects that banks utilizing the services of CIT sub-advisors will exercise periodic reviews of sub-advisor performance, style consistency, and investment of fund assets in a manner consistent with applicable investment guidelines.[23]

National banks are required to adopt and follow written policies and procedures that are adequate to maintain their fiduciary activities in compliance with applicable law.[24] The OCC has offered suggestions on risk management and on the development, implementation, and use of risk management procedures.[25] Under that guidance, a bank should be able to demonstrate control over the documents that afford clients access to CIT investment funds, including the maintenance of original documentation in a secure, centrally controlled location. The bank also should maintain a system of internal controls, including an effective audit program for assuring that the bank is adhering to the terms and conditions of CIT instruments (i.e., declarations of trust and participation agreements).[26]

[17] OCC Interpretive Letter No, 219 (May 25, 1989).

[18] 12 C.F.R. § 9.4.

[19] Id.

[20] See OCC Bulletin 2011-11, Collective Investment Funds and Outsourced Arrangements (a bank's delegation of its responsibilities to a third party does not relieve the bank of its responsibilities as a fiduciary) and OCC Bulletin 2020-10, Third-Party Relationships: Frequently Asked Questions to Supplement OCC Bulletin 2013-29 (March 5, 2020).

[21] See OCC Bulletin 2013-29, Third-Party Relationships: Risk Management Guidance (Oct. 30, 2013).

[22] Id.

[23] See Comptroller's Handbook, Investment Management Services (Aug. 2001), at 25.

[24] 12 C.F.R. § 9.5.

[25] OCC Bulletin 2011-12, Sound Practices for Model Risk Management: Supervisory Guidance of Model Risk Management.

[26] Id.

continued

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A national bank also is required to conduct a formal review of all of the assets for which it has investment discretion at least once per year.[27] The review must determine whether CIT assets are being invested in a manner consistent with the fund's plan and investment strategy.[28] It should also reflect deliberation on the fund's investment objectives and guidelines and investment performance, as well as reaffirm or change the investment objectives and guidelines as appropriate.

TO SUMMARIZE: Reg. 9 and the OCC's related guidance emphasize the importance of ongoing bank monitoring and oversight of CIT functions, including oversight of any services of subadvisors and other vendors as an essential element of maintaining CITs. The trustee of a CIT may not function as a mere custodian, but needs to undertake active, ongoing due diligence and inquiry as to whether the needs of the CIT are being met and whether the interests of the CIT are being properly served. As noted, the principles of Reg. 9 are looked to by regulators, including the FDIC, as "best practices" for CITs maintained by state-chartered institutions.

B. The second leg of the triad – the federal securities laws

Sections 3(c)(11) of the Investment Company Act of 1940 (the '40 Act) and 3(a) (2) of the Securities Act of 1933 (the '33 Act) make available to CITs counterpart exemptions from the registration and related disclosure and reporting requirements under each of those statutes. In order to qualify for the exemptions, CITs must be "maintained by a bank" and must consist solely of assets of one or more trusts of certain types of retirement plans—primarily those that meet qualification requirements under Code section 401(a), certain types of governmental plans or church plans.[29]

The Staff of the Securities and Exchange Commission (SEC) has stated that it would not be inconsistent with the "maintained by" requirement for a bank to retain an investment advisor to assist with the management of CIT assets.[30] However, the Staff has made clear that a bank may not go so far as to entirely out-source CIT investment management responsibilities by relying completely on the efforts of a retained investment advisor. In the view of the SEC, the key phrase embedded within the exemptions—referencing CITs that are "maintained by a bank"—requires a bank relying on the exemptions to exercise "substantial investment responsibility" over CIT assets; a bank that functions in a mere custodial or similar capacity with respect to CIT assets fails to satisfy the requirement.[31] In no-action letter guidance, the SEC Staff has indicated that a bank relying upon the recommendations of third-party investment advisors for purposes of managing CIT assets would need to approve or authorize those investment decisions contemporaneously or in advance to demonstrate the exercise of substantial investment responsibility.[32]

The Frank Russell no-action letter referenced in footnote 32 describes an approach to CIT investment management that is widely used today. There, the bank maintaining CITs indicated its intent to retain the services of one or more investment advisors to furnish it with advice and recommendations concerning the specific securities to be purchased and sold by CITs. The bank indicated it also

[27] 12 CFR §9.6.

[28] See Comptroller's Handbook, Asset Management, Collective Investment Funds, Version 1.0 (May 2014), at 19.

[29] The '40 Act defines the term "bank" in section 2(a)(5) to include depository institutions as defined under the Federal Deposit Insurance Act, a Federal Reserve System member bank and "any other banking institution or trust company ... doing business under the laws of any state of the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks under the authority of the Comptroller of the Currency and which is supervised or examined by State or Federal authority having supervision over banks ... ." The '33 Act's section 3(a)(2) exemption incorporates the same'40 Act definition by reference.

[30] First Liberty Real Estate Fund, SEC No-Action Letter (July 14, 1975).

[31] See, Employee Benefit Plans, Securities Act Rel. No. 6188 (Feb. 1, 1980).

[32] See, e.g., Frank Russell Trust Co., SEC No-Action Letter (July 11, 1980).

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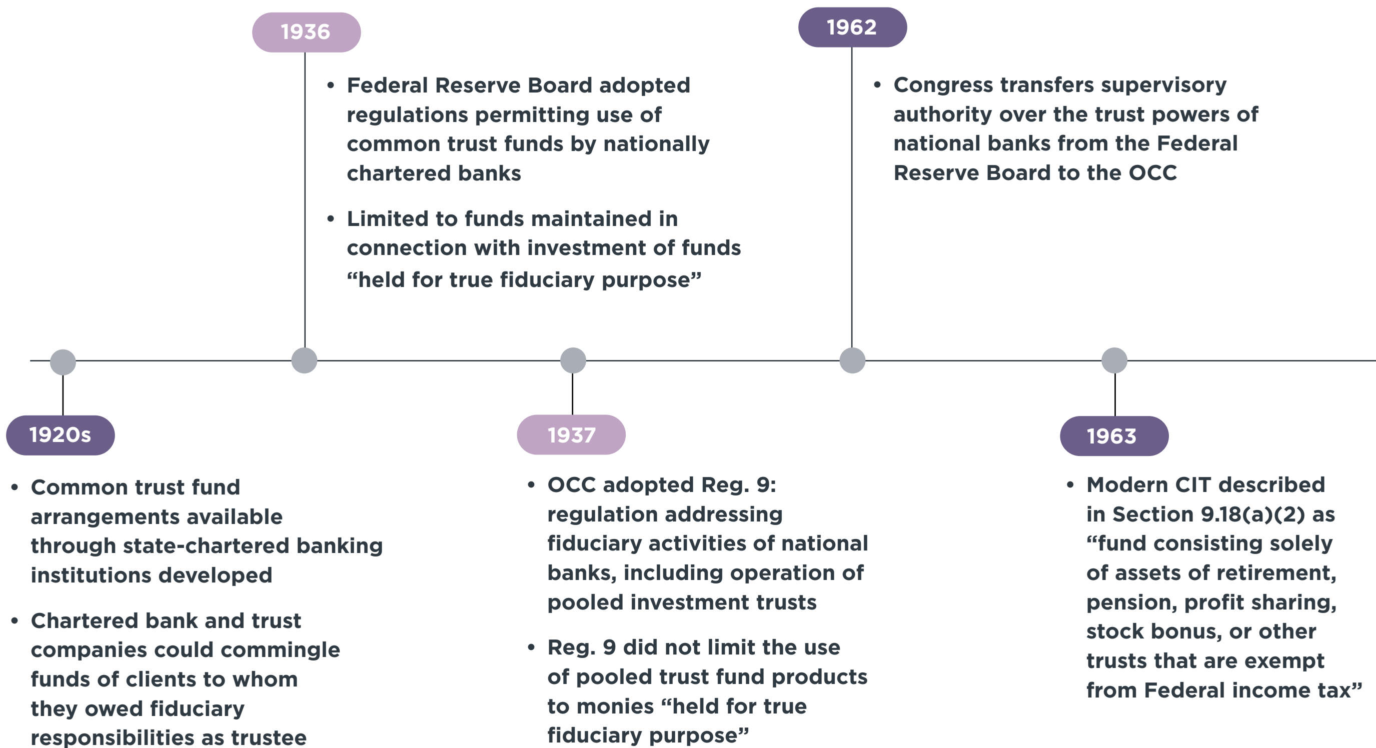
The emergence of modern CITs



intended to utilize consulting services provided by a non-bank affiliate to identify and evaluate the investment advisors that it might choose to engage. Importantly, while the bank indicated it expected to rely upon the recommendations furnished by these investment advisors and consultants, it represented that it would retain complete discretion to accept or reject that advice. The bank also represented that it would maintain staffing levels appropriate for making those determinations. In granting the requested no-action relief, the SEC Staff expressed the view that the approach would satisfy the "maintained by a bank" requirement under the Section 3(c)(11) and 3(a)(2) exemptions because the bank's use of staff to oversee and to accept or reject the input of third-party advisors would involve an exercise by the bank of "substantial investment responsibility" over the CIT.[33]

In a 2006 SEC enforcement proceeding involving a common trust fund claiming exemption from registration under section 3(c)(3) of the '40 Act (which contains an identical "maintained by" requirement), the SEC concluded that the requirement would not be satisfied where a trust fund served as an intermediary vehicle for investors to indirectly invest in privately offered investment funds that were unavailable for direct investment.[34] In that case, the SEC expressed the view that the bank did not truly "maintain" the common trust fund but was merely a directed investment arrangement because investors in the fund instructed the trustee as to the ultimate investment of the common trust fund into underlying private investment vehicles.

More recently, in 2020 the SEC determined that a trustee failed to satisfy the

[33] Id.

[34] In re Dunham & Associates, Inc., SEC Securities Act Rel. No. 8740 (Sept. 22, 2006).

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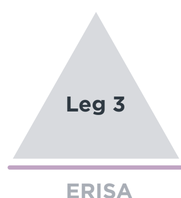
"maintained by" requirement for both its common trust and collective trust funds.[35] In that case, the trust company sponsoring the funds relied upon the services of an affiliated investment advisor to assist with the management of the funds. The SEC faulted the trust company for engaging in only minimal oversight of its investment advisor affiliate, alleging that the advisory affiliate performed virtually all investment activities on behalf of the funds, including investment due diligence, investment selection, purchase and sales activities, and monitoring for performance and risk. The SEC also noted that the trustee's oversight of its advisor affiliate was "cursory," largely limited to the passive receipt of information and reports submitted by the advisor and rarely resulted in any investment changes or feedback to the advisor in respect of the funds' investment strategy. Id.

TO SUMMARIZE: The federal securities laws compliance needs for well-designed and implemented CIT governance practices are clear and unmistakable—CITs are "maintained by a bank" and therefore eligible for the federal securities laws exemptions that may allow for cost savings relative to mutual funds, only where the bank exercises substantial investment authority, including through subadvisor oversight and contemporaneous or advance approval of subadvisor recommendations.



C. The third leg of the regulatory triad—ERISA

ERISA assigns fiduciary responsibilities to persons who engage in certain functions, including to persons who exercise authority or control over the management or disposition of the assets of an ERISA-covered plan.[36] Trustees to ERISA-covered plans are always fiduciaries.[37]

Under U.S. Department of Labor (DOL) regulations, where an ERISA-covered plan acquires or holds an investment interest in a common or collective trust fund of a bank, the assets of the plan include both an investment interest in the trust itself and an undivided interest in each of the underlying assets of the trust.[38] Accordingly, whenever a CIT admits one or more ERISA-covered plans as an investor, that CIT instantly becomes an ERISA "plan assets vehicle." Consequently, the CIT trustee is responsible as an ERISA fiduciary to each such participating plan. This contrasts with the ERISA treatment of mutual funds, which are not plan assets vehicles. Therefore, those who are responsible for the management of a mutual fund's asset portfolio, including the mutual fund's investment advisor, are not responsible as ERISA fiduciaries to plans that invest in the mutual fund.

1. ERISA fiduciary duties

ERISA section 404 imposes standards of conduct on persons who act as fiduciaries. These general fiduciary responsibility provisions include requirements that the fiduciary act prudently, solely in the interest of plan participants and beneficiaries, and for the exclusive purpose of paying benefits

[35] Great Plains Trust Company, Inc., SEC Release No. 33-10869, 2020 WL 5820419 (Sept. 30, 2020).

[36] ERISA § 3(21)(A)(i).

[37] 29 C.F.R. § 2509.75-8.

[38] 29 C.F.R. § 2510.3-101(h)(1).

[39] Section 401(b)(1) of ERISA excludes a mutual fund's underlying holdings from plan assets treatment. It provides—"in the case of plan which invests in any security issued by an investment company registered under the Investment Company Act of 1940, the assets of such plan shall be deemed to include such security but shall not, solely by reason of such investment, be deemed to include any assets of such investment company."

[40] ERISA § 404(a)(1)(A), (B).

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under the plan and defraying reasonable expenses.[40] We discuss these responsibilities in more detail below.

a. Duty of prudence

ERISA fiduciaries must act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."[41] In considering whether a fiduciary has acted in a manner that satisfies the duty of prudence under section 404, courts generally focus on the fiduciary's conduct in arriving at a decision, not on the decision's results. In this regard, courts frequently inquire as to whether a fiduciary used appropriate methods to investigate and determine the merits of a particular decision.[42] Whether a fiduciary acted prudently depends on "whether the fiduciary engaged in a reasoned decision-making process, consistent with that of a prudent man acting in a like capacity."[43]

The DOL has indicated that a fiduciary's obligation to carry out its duties "prudently" is generally met to the extent that the fiduciary follows a "procedurally prudent" process by (i) gathering relevant information, (ii) considering all available courses of action, (iii) consulting experts where appropriate, and (iv) making a reasoned decision based on all relevant facts and circumstances. Such a process should be designed to avoid self-dealing, conflicts of interest, or other improper influence.[44]

A fiduciary may choose to obtain independent financial or legal advice to assist it in managing its responsibilities. Some courts have indicated that the act of seeking out such advice is demonstrative of having undertaken a prudent and thorough investigation.[45] However, most courts have regarded the mere act of obtaining advice from an independent advisor as insufficient, in and of itself, to establish that a fiduciary acted prudently.[46]

b. Duty of loyalty

ERISA's fiduciary duty of loyalty requires plan fiduciaries to act for the "exclusive purpose of providing benefits to participants and beneficiaries; and defraying reasonable expenses of administering the plan."[47] This duty of loyalty has been described to require that fiduciaries act with an "eye single" to the interests of plan members and beneficiaries and without regard to the interests of any other persons.[48] However, a fiduciary action that "incidentally benefits" the interests of the fiduciary itself does not violate the exclusive purpose rule where the fiduciary reasonably concludes, following prudent inquiry, that the action is in the

[41] ERISA § 404(a)(1)(B).

[42] See, e.g., In re Unisys Savings Plan Litigation, 74 F.3d 420, 434 (3d Cir. 1996).

[43] See DiFelice v. U.S. Airways, Inc., 497 F.3d 410, 420 (4th Cir. 2007); see also Eyler v. Comm'r of Internal Revenue, 88 F.3d 445, 454 (7th Cir. 1996) (a court must consider whether a fiduciary "employed the appropriate methods").

[44] DOL Field Assistance Bulletin 2003-02 (Nov. 22, 2003).

[45] See, e.g., Chao v. Hall Holding Co., 285 F.3d 415, 430 (6th Cir. 2002); Howard v. Shay, 100 F.3d 1484, 1489 (9th Cir. 1996).

[46] Martin v. Feilen, 965 F.2d 660, 670 (8th Cir. 1992) (securing an independent assessment from a financial advisor or legal counsel is not a complete defense to a charge of imprudence); DiFelice v. U.S. Airways, Inc., 2007 WL 2192896 at *8 (4th Cir. 2007) (although plainly independent advice provides evidence of a thorough investigation, it is not a "whitewash").

[47] ERISA § 404(a)(1)(A).

[48] Donovan v. Bierwirth, 680 F.2d 263, 271 (2d Cir.), cert. denied, 459 U.S. 1069 (1982).

[49] Id., at 271.

[50] Rozo v. Principal Life Ins. Co., No. 4:14-cv-00463-JAJ, 2021 WL 1837539, at *20 (S.D. Iowa Apr. 8, 2021).

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best interests of the plan participants and beneficiaries.[49] A recent court decision noted that a fiduciary's adherence to a demonstrably prudent decision-making process provides an inference that that ERISA fiduciary's motive was to act "in the interest of the participants."[50]

2. Duty to avoid prohibited transactions

The general fiduciary responsibility requirements of ERISA are supplemented by rules restricting fiduciaries from causing a plan or a plan assets vehicle from engaging in "prohibited transactions." In general, under ERISA, most transactions involving related parties are prohibited unless an applicable statutory or administrative exemption applies. The prohibited transaction rules are contained in two parts: the party-in-interest restrictions under ERISA section 406(a), and the fiduciary self-dealing and conflict-of-interest prohibitions under ERISA section 406(b).

ERISA section 406(a) prohibits a fiduciary from causing a plan to engage in a transaction if the plan fiduciary knows or should know that the transaction will involve, directly or indirectly, one or more of certain categories of transactions with a "party in interest." The term "party in interest" includes fiduciaries, service providers, employers of plan participants, corporations that are 50-percent owned by a party in interest, and employees, officers, directors, and 10-percent owners of certain parties in interest.[51]

Specific transactions prohibited by ERISA section 406(a) include a sale or exchange of property between a plan and a party in interest; a lending or extension of credit between a plan and a party in interest; the provision of services by a party in interest to a plan; and the transfer to, or use by or for the benefit of, a party in interest of any assets of the plan.

ERISA section 406(b) generally prohibits a fiduciary from acting under a conflict of interest. ERISA section 406(b)(1) prohibits a plan fiduciary from dealing with plan assets in the fiduciary's own interest or for the fiduciary's own account. ERISA section 406(b)(2) prohibits a fiduciary from acting on behalf of a party whose interests are adverse to the interests of the plan or its participants in a transaction involving plan assets. ERISA section 406(b)(3) prohibits a fiduciary from receiving consideration for its own personal account from any party dealing with the plan in connection with a transaction involving plan assets. The DOL has explained that a violation of ERISA section 406(b) will occur when a fiduciary uses the authority, control, or responsibility that makes the person a fiduciary in a transaction where the fiduciary has interests that may affect its best judgment as a fiduciary.[52]

TO SUMMARIZE: Under ERISA, banks that maintain CITs are responsible as fiduciaries when they manage the assets of those plans. As such, banks are required to manage those assets prudently, solely in the interests of the plans, and in a manner that avoids giving rise to a non-exempt prohibited transaction. While the common practice of engaging one or more expert

[51] ERISA § 3(14).

[52] 29 C.F.R. § 2550.408b-2(e).

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investment advisors to assist the bank in its management role is consistent with the principles of prudence, it is insufficient, in and of itself, to discharge that duty. Consistent with the duties of prudence and loyalty that ERISA imposes, where a fiduciary relies upon an expert, including a subadvisor, it is obligated to evaluate and consider the expert advice and recommendations

Demonstrating prudent oversight through good CIT governance

Adopting and applying sound policies and procedures

Governance approaches	Best practices
Banking and securities laws	Maintain "exclusive management" authority over the CIT, subject to its powers of prudent delegation
Federal securities laws	Bank must in fact "maintain" the CIT by exercising "substantial investment responsibility" over CIT Assets
ERISA fiduciary standards	Trustee of CIT to manage the CIT's affairs in a procedurally prudent manner to assure that the standards of conduct applicable under ERISA section 404 are met and prohibited transactions are avoided
Bank organizational structure	Establish appropriate structure for CIT governance, with clear delineation of authority, responsibility, and accountability
Third-party oversight	Designate an officer or committee to periodically check that the third-party vendor has adequate systems and executing proper procedures for things such as trading and determining plan eligibility
Subadvisor oversight	Periodic reviews of subadvisor performance, style consistency, and investment of fund assets in a manner consistent with investment guidelines

that it receives, including the qualifications of the provider(s) of that advice. Such a process would also seek to avoid non-exempt prohibited transactions. Well-governed bank CITs apply these principles by engaging in regular oversight of expert subadvisors and of their recommendations and by taking appropriate steps to ensure ongoing compliance with applicable prohibited transaction exemptions.

III. Demonstrating Prudent Oversight Through Good CIT Governance

As noted above, this paper uses the term "governance" to refer to the policies and procedures banks and trust companies may utilize for purposes of overseeing and authorizing decision-making on behalf of CITs. Good governance is the means by which CIT trustees demonstrate adherence to the active due diligence and prudent oversight principles that are a thematic focus under each leg of the regulatory triad.

While there are a number of governance approaches available, the decision on which approach to use partially depends on the facts and circumstances of each financial institution that sponsors CITs. Whatever the approach to governance, the overriding regulatory directives that some appropriate governance be maintained under each leg of the regulatory triad described above is clear.

First, as a matter of federal banking regulation, the OCC has made clear that the

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bank, through its board of directors and the board's assigned directors, officers, employees or committees, must maintain "exclusive management" authority over all CITs, subject to its powers of prudent delegation; state banking regulators generally conform to the OCC's rules. Second, for purposes of maintaining compliance with applicable exemptions from registration under the federal securities laws, the bank must in fact "maintain" the CIT by exercising "substantial investment responsibility" over CIT assets. Third, as an ERISA fiduciary, it is incumbent upon the CIT trustees to manage the affairs in a procedurally prudent manner to assure that the standards of conduct applicable under ERISA section 404 are met and that non-exempt prohibited transactions are avoided.

The OCC does not prescribe a one-size-fits-all approach to governance. Instead, it notes that governance structures and practices should keep pace with changes in size, risk profile, and complexity relevant to a financial institution and its businesses.[53] Typically, the bank's board of directors establishes an appropriate organizational structure for CIT governance, with clear delineation of authority, responsibility, and accountability.

Many, if not most, financial institutions choose to implement a committee structure for CIT oversight purposes. These oversight committees approve and implement policies and procedures, including policies and procedures for selecting and monitoring subadvisors. Committees may also establish subgroups, or subcommittees, charged with specific areas of responsibility.

The authorities assigned to a committee are typically outlined in a charter document that would preferably afford some level of flexibility for the delegation of responsibilities. Ideally, delegations should be appropriately documented to make clear that the committee has selected a delegate to act on its behalf for a specific function. Documentation should also define the scope and extent of the delegated functions and be executed by both the committee and the delegate. After a committee has been established, it should meet on a regular basis and maintain meeting minutes to document its decision-making process.

A critical aspect of good fiduciary governance is ensuring that CIT fiduciary oversight functions have been specifically assigned to one or more designated committees, subcommittees and/or delegated personnel—and that those designees or delegees are actively performing the oversight functions for which they are responsible and regularly reporting back. This involves periodic checking by the bank's senior management to make sure that those responsible for CIT governance are fully informed about the specific oversight functions arising under applicable law; have taken the necessary steps to ensure that those specific oversight functions have been assigned; and that the personnel responsible for those assignments are actually performing the assigned functions. While a complete description of all oversight functions applicable to CIT governance is beyond the scope of this paper, we have listed several key fiduciary oversight items below.

As noted, Reg. 9 provides that a national bank may use qualified personnel and facilities of affiliates to perform services related to the exercise of its fiduciary

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[53] Comptroller's Handbook, Safety and Soundness, Corporate and Risk Governance Version 2.0 (July, 2019) at 1.

[54] Comptroller's Handbook, Asset Management, Collective Investment Funds, Version 1.0 (May, 2014), at 32 (emphasizing the need for national banks to attract, develop, and retain appropriately qualified personnel).

[55] Id.

[56] 12 C.F.R. § 9.4.

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powers. The OCC has emphasized that such personnel need to be qualified and competent, and should perform appropriately.[54] They must also comprehend the bank's mission, values, principles, policies, and practices.[55] A national bank may also, pursuant to a written agreement, purchase services related to the exercise of fiduciary powers from another bank or other entity.[56] However, the use of third-party services in connection with the operation of CITs remains subject to meeting the "exclusive management" requirement under section 9.18(b)(2). To the extent third parties are being utilized, the governance structure should assign or otherwise make provisions for overseeing those vendors for purposes of assuring that they are conducting their services in a sound manner and in compliance with applicable law.

For example, if CITs rely on third-party intermediaries to serve as conduits between participating plans and the bank, an appropriate governance mechanism would be to designate an officer or committee to periodically check that the third-party vendors have adequate systems in place to assure that only eligible plans are admitted to participate in CITs. Similarly, periodic checks should be made to assure that third-party vendors are executing CIT admissions and withdrawals on a timely basis, monitoring trading activity to guard against "late trading" and "market-timing" abuses, and correctly assessing and collecting fees. The appropriate officer or committee should document that these checks have taken place.

With respect to the use of subadvisors, we have noted above that the OCC is concerned that banks not "rent their charters" to third-party registered investment advisors seeking to use the bank's status as a fiduciary to sponsor one or more funds on their behalf.[57] Periodic reviews of subadvisor performance, style consistency, and investment of fund assets in a manner consistent with applicable investment guidelines would be consistent with the prudent exercise of oversight responsibilities. These reviews should be documented in meeting minutes, written reports, or both. The bank's governance structure should assign responsibility for regular comparisons of subadvisor performance to benchmarks to the appropriate officers or committee members. The structure should also assign responsibility for supervising and being able to describe how an appropriate benchmark was selected.

As a matter of federal securities law compliance, it is critical that the bank's governance process provide for ongoing receipt and review of subadvisor trades, consistent with its obligation to exercise substantial investment responsibility over CITs. It would be consistent with sound governance to contemporaneously review the trades for consistency with CIT's investment guidelines, to make sure they are not otherwise imprudent and to take appropriate steps to set aside or reverse problematic trades should they arise.

The focus on process and procedure that comes with good CIT governance is consistent with adherence to the ERISA duty of prudence, which has a strong process orientation. In addition, and as noted, adherence to a rigorous oversight process is also useful in demonstrating adherence to the ERISA duty of undivided

[57] See OCC Bulletin 2011-11, Collective Investment Funds and Outsourced Arrangements (a bank's delegation of its responsibilities to a third party does not relieve the bank of its responsibilities as a fiduciary).

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loyalty, as well as in monitoring for compliance with applicable prohibited transaction exemptions.

A sound governance structure involves identifying the ERISA-prohibited transaction exemptions relied upon by CITs, assuring that the scope of relief afforded by the exemptions is sufficient to cover necessary CIT transactions, and that the CIT is meeting applicable conditions for relief. Where a subadvisor or another third party is responsible for prohibited transaction exemption compliance, good governance would seek to apply an appropriate level of oversight over such third-party's compliance.

In conclusion, adopting and applying sound policies and procedures for CIT governance is a regulatory imperative for banks that act as CIT trustees. Good governance practices are also protective of CIT investor interests by helping to assure that CIT investment objectives are being advanced in an appropriate manner. In light of that protective function, 401(k) plan sponsors, advisors, and other plan fiduciaries may wish to inquire about CIT governance practices when evaluating CITs as potential plan investment options.

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