

<b>FIDUCIARY INVESTMENT COMPLIANCE CHECKLIST</b>
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The objective of the following checklist is to assist investment fiduciaries who are subject to ERISA or the Uniform Prudent Investor Act. The checklist is useful for Public Fund fiduciaries, but should check their state's statutes for additional requirements.

An overview of the broad fiduciary requirements includes:

### **Uniform Code of Fiduciary Conduct**

1. *Prepare written investment policies, and document the investment decision making process.*
2. *Diversify assets with regard to specific risk/return objectives of participants and beneficiaries.*
3. *Use "prudent experts" to make investment decisions.*
4. *Control investment expenses, and ensure the "best execution" of investment transactions.*
5. *Monitor the activities of all money managers and service providers.*
6. *Avoid all conflicts of interest.*

#### **I. Review of Plan or Trust Documents**

- A. Fiduciaries and trustees are named and responsibilities are assigned among named fiduciaries and trustees.
- B. Plan/ trust documents allow for the fiduciaries to designate persons other than named fiduciaries to be responsible for certain functions; i.e., appointment of professional money managers.
  - 1. Vendor agreements are in writing and do not exceed terms of greater than three years.
  - 2. Vendor agreements are being followed (i.e., fee, charges, reports, etc.).
- C. Written evidence is maintained of consistent supervision and evaluation of investment program.
  - 1. Minutes of meetings of Trustees or Investment Committee are maintained and are current.
  - 2. Appropriate documentation is in place regarding monitoring of plan assets.

- D. Investigation is made into any possible prohibited transactions, specifically whether a fiduciary or party in interest is receiving any direct or indirect benefit from use or sale of plan assets.

## **II. Review of Investment Policy Statement (IPS)**

- A. Investment objectives are identified.
- B. Asset allocation guidelines are identified.
  - 1. Risk tolerance or variability of returns.
  - 2. Asset classes are appropriate for consideration.
  - 3. Time horizon to achieve objectives or to meet distribution requirements.
  - 4. Expected return on investments compare to designated benchmarks.
- C. Strategic asset allocation is set and rebalancing variance limit is identified.
- D. Securities guidelines are identified for each asset class.
- E. Restricted securities are identified.
- F. Procedures are established (due diligence) for selecting “prudent experts” to make investment decisions.
  - 1. Performance numbers are reviewed and are time weighted, composite of actual results. Long-term performance outperforms appropriate market indices.
  - 2. Performance is compared relative to risk assumed. Managers have positive alpha or high Sharpe ratio. Standard deviation of manager is reported and understood.
  - 3. Performance is compared against managers of like style or strategy. Long term performance is in upper median of an appropriate manager universe.
  - 4. Manager follows specific investment style that corresponds to evaluated performance record.

- 5. Manager and/or custody organization is able to properly service account.
- 6. The track record evaluated is attributable to specific investment manager assigned to portfolio.
  - a. A registered investment advisor under the Investment Adviser's Act of 1940, insurance company, bank or investment company.
  - b. Prudently selected (due diligence procedures outlined above).
  - c. Given power to manage, acquire and dispose of the plan assets.
  - d. Acknowledging responsibility in writing.
  - e. Properly monitored and supervised.
- G. Control procedures are established.
  - 1. Responsibilities of money manager.
    - a. Vote proxies, if instructed.
    - b. Annually submit an ADV Part II.
    - c. Notify fiduciaries when involved in any litigation or violation of securities regulations.
    - d. Appropriately register (if required) in state.
    - e. Notify clients of any material changes in personnel and ownership.
  - 2. Monitoring of money managers.
    - a. Manager's adherence to IPS.
    - b. Material changes to manager's organization.
    - c. Comparisons of manager's performance to indices, managers of similar style, and to IPS objectives.

- 3. Review of costs and fees for reasonableness of services provided.
  - a. Administrative costs.
  - b. Money management fees.
  - c. Custody fees.
  - d. Brokerage costs (best execution).
  - e. Soft dollar arrangements are acknowledged and understood.

**III. Specific to ERISA Fiduciaries – Defined Benefit Plans and 401(k) Plans**

- A. Funding status of plan is noted – over or underfunded.
  - 1. Actuarial assumptions are verified (if Defined Benefit Plan).
  - 2. Contributions and allocations are appropriate (if Defined Contribution).
  - 3. If participant directed, investment choices are appropriate directed, investment choices are appropriate under ERISA Sec. 404(c).
- B. Short term liquidity needs are identified.
  - 1. Matching assets with age of participants.
  - 2. Employment contracts and vesting schedules.
- C. Flow of funds (contributions and distributions) are noted.
  - 1. For one, three and five years.
- D. Summary Plan Description.
  - 1. Verify that it is consistent with Plan Documents.
  - 2. Should be written in easy to understand language.
  - 3. Should have provided to each Participant.

- E. Annual Return has been timely filed with IRS.
  - 1. Forms 5500, 5500-C, and 5500-R.
  - 2. Review any IRS correspondence regarding Plan.
- F. Summary Annual Report.
  - 1. Has been provided to Participants within 270 days after the end of each Plan year.
  - 2. Review previous Annual Reports for consistency.
- G. Required ERISA bonding is in force (*ERISA Sec 412(a)*).
- H. Loan provisions do not violate prohibited transaction rules and meet minimum requirements.
  - {ERISA Sec. 406(a)-(b)}*(DOL Reg. Sec 2550.408(b)-(1))
  - 1. Plan documents permit the use of loans
  - 2. Loans are available to all participants.
  - 3. Loans are not available to highly compensated employees in greater amounts than to other employees.
  - 4. Loans bear a reasonable rate of interest.
  - 5. Loans are adequately secured.
- I. Plan investment assets are subject to jurisdiction of U.S. district courts – no foreign assets unless held by a US intermediary. (*ERISA Sec 404(a)(2)*)
- J. Prohibited transactions under IRC Sec 4975 (and regulations) are avoided.
- K. Claim Review Procedures are specified for benefit payment controversies. *{ERISA Sec. 502}*.
  - 1. Specific steps are clear and provided to participants. (Note: This has become an area of inquisition by lawyers representing disgruntled participants.

<b>FACT FINDING AND DATA GATHERING</b>
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**I. Retirement Plans**

- A. Qualified plans. Review the following documents:
- Trust Agreement and Amendments;
  - IRS Form 5500 – Including schedules;
  - Independent Accountants Audit Report, if required by IRS;
  - Plan Documents;
  - Summary Plan Description; and
  - Actuarial Report (defined benefit plans only) which identifies interest rate and investment earning assumptions, and the funding status of the Plan.
- B. Public Plans – similar to qualified plans:
- audited reports showing the timing of contributions and disbursements,
  - funding status, and
  - participant demographics.
- C. Funded Non-qualified retirement accounts (SERP's, Rabbi Trusts, Top Hat plans, etc.) – similar to qualified plus:
- Health and viability of company sponsor to be able to continue to fund obligation, and
  - Disparity between participant formulas and calculations.
- D. Individual retirement accounts (IRAs). (See Individuals, below)

Notes:

- (1) The Plan documents will indicate the timing of contributions and disbursements, which is critical in developing the investment strategy appropriate for the Plan assets. In order to appropriately determine the time horizon for a plan that pays lump sum benefits upon retirement, it may be helpful to construct two tables – one

depicting the participant balances based on the top ten to fifteen percent (10-15%) in account size; and the second depicting the top ten to fifteen percent (10-15%) participant age groups.

- (2) In order to understand participant demographics, it is also useful to prepare two histograms – one that depicts years of service and one that provides an age distribution. This helps determine time horizon and performs the necessary due diligence to analyze plan participant characteristics.

**II. Foundations / Endowments / Charitable Trusts** – In a charitable setting, the pool of money needs to be examined by gathering the following documents:

- 1. Trust Agreement, including Amendments.
- 2. IRS forms, filings and audit reports.
- 3. Term of years if remainder or lead trust.
- 4. Independent Annual Audited Financial Statement.

Note: Charitable entities may have political reasons (or justifications) in using certain custodians, money managers or investments. Although a charitable gift may be complete from a tax standpoint, there are usually ties or unwritten requirements that the donor made when the gift was funded.

**III. Individual (Or Couple) Accounts** – The individual or couple should provide:

- A. Income history – Both earned and unearned.
- B. Date of birth(s) – This is critical in developing the time horizon for the portfolio. Many times, time horizon by an individual investor may be thought of in terms of number of years between now and retirement. This is not the case. The true time horizon should be based upon the individuals life expectancy (giving consideration to parent’s and grandparent’s longevity) and/or intended bequests.
- C. Copy of prior years tax returns (Form 1040), brokerage statements and/or other relevant reports. Tax returns can many times be a discovery tool since they will list dividends and capital gain transactions. Although the number of shares owned may not be know, it is possible to arrive at the shares owned based on the total dividends reported.

**Family Trust** – Like the individual situation, the Family trust needs to be analyzed in terms of its income history and beneficiary profile.

- A. The governing trust document, including amendments, to determine:
  - Beneficiaries – current and future;
  - Mandatory and discretionary distribution dates and contingencies;
  - Payment requirements of interest and principal; and
  - Investment restrictions and prohibitions.
- B. Audit report prepared by an independent or family accountant (if available).
- C. IRS Form 1041 – Including supporting schedules.
- D. A list of all beneficiaries and their birth dates. A Family tree may be necessary to reflect relationships and beneficiaries. Like the individual, the birthdays of the beneficiaries may determine the time horizon. These need to be for all current and future beneficiaries including class of beneficiaries (e.g., after-born grandchildren).

***PROVIDED AS A COURTESY: Chartwell Consulting (USA) LLC***

**SOURCE:** “***Procedural Prudence for Fiduciaries***”

The handbook for The Management of Investment Decisions  
by Donald B. Trone, William R. Allbright, Philip R. Taylor