

Retirement Report

NEWS AND UPDATES FOR PLAN SPONSORS AND
FIDUCIARIES OF DEFINED CONTRIBUTION PLANS

Happy Holidays from Gateway Retirement Consulting!

On behalf of everyone at Gateway Retirement Consulting, it is my pleasure to extend you the greetings of this special season. We are grateful you selected us as your dedicated retirement plan consultant. We saw plenty of activity in the retirement plan landscape in 2016—from market volatility at the top of the year to the announcement of the DOL's Fiduciary Rule—and look forward to what 2017 will bring and keeping you abreast of the current events within the industry. We are fiercely proud to be your retirement plan consultant, helping protect you as a fiduciary and assisting your plan participants prepare for a meaningful retirement. Congratulations for all you accomplished in 2016.

As we do each December, this month's *Retirement Report* highlights excerpts from issues published in 2016. Please contact Gateway Advisory with any questions or feedback; we look forward to serving you in 2017!

Fiduciary Liability Insurance *Published January 2016*

Plan sponsors are often concerned with the prudence and process of obtaining insurance covering ERISA retirement plan fiduciaries. While fiduciary insurance is an important aspect in mitigating the financial impact of fiduciary litigation, there are a number of additional, important activities that are prudent for fiduciaries to embrace.

ERISA fiduciaries are well advised to follow a comprehensive strategy to optimize fiduciary risk mitigation. Other important risk mitigation steps include identifying who the plan's named fiduciary is, delegating fiduciary responsibilities to co-fiduciaries (e.g., steering committee) as appropriate and allowable, implementing a sound fiduciary structure (via committee charter with ancillary paperwork), consistently practicing procedural prudence as defined by ERISA for all fiduciary-level plan decision making, hiring experts as needed to fulfill ERISA's prudent expert requirement, documenting all fiduciary decision-making processes and results, and auditing administrative procedures periodically to ensure compliance with ERISA and the plan document (this is a source of many unintentional fiduciary breaches). Ask your plan consultant to provide a more complete explanation of this important topic.

Returning to the specific topic of fiduciary insurance, please note that typically, most corporate-level liability insurance policies (directors and officers liability insurance (D&O), employee benefit liability coverage) do not address ERISA fiduciary breaches. If ERISA-specific language is not included in a liability policy, ERISA breaches are most likely not covered. Comprehensive fiduciary insurance is relatively affordable and typically does cover all plan fiduciaries. ERISA fiduciary coverage can be obtained as an addendum to an existing liability policy, or as a separate policy, depending upon the issuer.

Not all fiduciary liability policies are created equal, and some issuers are more astute about this coverage than others. It is prudent to confirm that the issuer you are considering to provide coverage has experience and expertise in providing ERISA fiduciary coverage. A few areas to focus on, other than what would normally be considered in reviewing any insurance policy, are:

- Does the policy specifically cover ERISA fiduciary breaches?
- Does it cover the appropriate individuals?
- Does the policy contain carve-out language that eviscerates the effectiveness of the policy?

Do review all language contained in the contract, especially in areas of coverage exclusions and limitations, provisions for legal representation in event of a claim, and specific and aggregate dollar limits of coverage.

Another important area of concern in terms of policy language is the application for coverage. As with most insurance contracts, the signed application for coverage is considered part of the contract. We have noticed many applications that ask the fiduciaries to affirm that there has never been a fiduciary breach associated with the plan. In our opinion, this is an affirmation that is not practicable to assert, as many unintentional fiduciary breaches (by far the most frequent category of breaches) may not be identified upon occurrence or until years after its occurrence. The affirmation can and may be used to nullify the insurance protection at time of a claim. It would be prudent to have the issuer insert, “to the best of my knowledge” language to this question. We believe that this is typically not an intentional attempt by the issuer to avoid a claim, but is often due to the issuer’s naivety concerning ERISA law.

To summarize, here are some steps you might follow in evaluating ERISA fiduciary insurance:

1. Check any existing corporate liability policies to determine if they cover ERISA fiduciaries (it may be more efficient to ask your broker to show you where in a policy it identifies that ERISA fiduciaries are covered).
2. If the policy does not cover ERISA fiduciaries, ask your broker to provide you with a quote for ERISA fiduciary insurance from a company that has expertise and experience in this area.
3. Keep in mind the specific provision areas of focus identified above (paragraphs four and five).
4. The amount of coverage is a judgement call. To our knowledge, there has not been an award that has approached 10 percent of plan assets, but it is theoretically conceivable that one could. Most successful litigation to date (other than those involving company stock litigation) is based on unreasonableness of fees, and fees are a relatively small percentage of total plan assets. Lawsuits can, and often do, contemplate a prolonged period of time based on when a breach originated and when it is corrected.
5. Designating a beneficiary will depend on whether there is a committee charter in place, which we highly recommend for most plans. If there is a formally executed committee charter delegating fiduciary responsibility from a plan’s named fiduciary (e.g., the company) to a committee, and the committee members are indemnified by the company, the beneficiary is most commonly the company. If committee

members have not been indemnified, then the committee members themselves (along with any other fiduciary members) should be named as beneficiaries as they would be held personally liable for fiduciary breaches in areas they are responsible for.

Please speak with Gateway Advisory if you have questions or would like more information on this important fiduciary topic.

The High Price of Yield and Perceived Safety

Published July 2016

Since the inception of markets there have been particular investments that garnered the attention of investors above all others. In the 1600s it was the tulip mania and at the turn of this century, tech stocks had investors' focus. Although not to the extent of these examples, currently low-volatility dividend paying stocks are the rage du jour in this low-yielding uncertain market environment.

The lack of yield available on bonds has driven yield-thirsty investors to bond proxies for income, such as dividend-paying stocks. Global economic uncertainty, as well as academic studies that touted the merits of low-volatility stocks, has exacerbated the flow of money into this type of investment. In 2015, over \$11 billion flowed into low-volatility exchange-traded funds and in the first two months of 2016, another \$5 billion.¹

Utilities and consumer staples lie at the epicenter of this low-volatility, bond proxy trade due to their lack of economic cyclicality and higher than average dividend yields. This has led to stretched valuations in these sectors. Between 1995 and the financial crisis, the average price-earnings ratio (the average of the ratio of a company's stock price to the company's earnings per share) of the utilities sector traded at a 25 percent discount to the broad market.² In contrast, utilities currently trade at a premium to the S&P 500 despite the sector's lower growth and profitability characteristics. Additionally, the forward price-earnings ratio (a current stock's price over its "predicted" earnings per share) on the consumer staples sector is over 20 times on average compared to the S&P 500 at about 17 times.³ This represents one of the largest premiums for staples in the last 20 years.

Valuation is a poor timing tool because valuations can remain extended for long periods of time. If bond yields remain depressed and the global economy continues to slow or deteriorate, this trade could continue to outperform for the time being. However, when investors are looking for perceived "safety" in low-volatility dividend paying stocks, buyers beware. When any investment trade becomes too crowded a reversion to the mean is likely to follow. This type of investment will be particularly vulnerable when interest rates eventually rise and their relative yield advantage dissipates. Certain investments will go in and out of favor over time which is why it is important to maintain a diversified portfolio with exposure to different asset classes, styles and sectors.

¹Courtesy of Financial Times

²<http://www.fa-mag.com/news/what-price-to-pay-for-yield-27285.html?section=68>

³<http://www.yardeni.com/pub/mktbriefsppesecind.pdf>

ERISA Update

Published September 2016

At a recent Western Pension Benefit Council/ASPPA Conference the new Fiduciary Rule was reviewed. The new Fiduciary Rule (definition) has come under significant criticism by many industry groups and Congress, some of whom brought litigation to redefine and suspend the effect of this regulation. To date, the DOL shows no intent to revise their position substantially. They indicate that the new rule is structured solely to protect participants and establish a high standard of care for fiduciary behavior. Regulators felt that the former definition of fiduciary was too broad and not as protective of participants as intended. In addition, the new Fiduciary Rule has been extended to include IRA products. The DOL spokesperson put to rest rumors that this regulation has any impact on plan sponsor fiduciaries.

A new updated 5500 form may be online in 2019, but could be delayed based on comment activity. The new form will provide increased transparency on plan investments. Also, Schedule C (Form 5500) fee disclosures will be revised to be more commensurate with ERISA Section 408(b) (2) data and more “mineable” for purposes of fee comparisons. The DOL suggested plan sponsors conduct fee reasonable determinations more frequently than is currently typically practiced.

Previous guidance regarding appropriateness of socially responsible investments clarified that there is no intended prohibition on these investments, but they should not be implemented if they could negatively impact risk/return considerations or compromise economic interest of the plan/participants in any way. In essence, the DOL suggests that all else being equal (fees, risk/return metrics, etc.) social responsibility is an acceptable tie-breaker.

Lastly, the DOL appears open to expanding guidance on self-correction of late deferral contribution errors under the Voluntary Fiduciary Correction program, though such guidance is not imminent.

Communication Corner: The Gift of Retirement

This month's employee memo celebrates this special time of year and reminds employees about the benefits of participating in your retirement plan.

As a reminder, we post each monthly participant memo on our website. Click [here to view this month's memo](#).

If you would like to speak with us about any of these topics, please call us at (877) 303-9580 or email us at: retirementconsulting@gatewayadvisory.com

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