PK RETIREMENT

Fiduciary Guide

Understanding the Investment Menu in Your Company's 401(k) Plan

As a business-leader who oversees your company's 401(k) plan, understanding the intricacies of the investment menu is essential. Why? The investment options available may play a significant role in shaping the retirement outcomes of your employees.

In this guide, we look at different ways to evaluate your current offering, discuss innovative ideas to assess your plan's investment strategies, and present opportunities that may be areas for improvement.

Establish an Investment Policy Statement (IPS)

Start with an investment policy statement. Your IPS is to help guide investment decisions, set performance benchmarks, outline risk tolerance, and help ensure that investment choices align with the plan's objectives and participants' needs. An IPS *may* include the following sections:

Plan Objectives

Defines the goals of the 401(k) plan, including expected outcomes for participants.

Risk Tolerance

Outlines the level of risk the plan is willing to take, balancing growth potential with participants' risk comfort.

Investment Selection Criteria

Specifies the criteria for selecting and evaluating investment options, such as performance history, fees, and alignment with plan goals.

Performance Benchmarks

Establishes benchmarks to measure the performance of chosen investments against market standards.

Diversification Guidelines

Provides guidelines for creating a well-diversified portfolio across various asset classes to help manage risk.

Rebalancing Policy

Sets rules for how and when the investment portfolio will be rebalanced to maintain target asset allocations.

Monitoring and Reporting

Defines the process and frequency for reviewing and reporting investment performance.

Roles and Responsibilities

Assigns responsibilities to the parties involved in managing the plan, such as the plan sponsor, investment committee, and advisors.

Compliance and Regulatory Standards

Includes guidelines to keep the plan in line with all relevant laws and regulations.

Amendment Procedures

Outlines the process for reviewing and updating the IPS as needed to adapt to changing conditions or objectives.

An IPS can help guide consistent and prudent decision-making. However, if the IPS isn't followed properly, it can lead to legal issues and claims against those responsible. Simply having an IPS isn't enough; it must be followed carefully to avoid potential problems.

Follow 404(c) guidelines

Under ERISA Section 404(c), which provides fiduciary protection for defined contribution plans like 401(k) plans, participants have control over their investment decisions. This allows them to build portfolios that align with their individual risk tolerance, investment objectives, and time horizon. The key features of a 404(c) plan include:

- **Participant control** | Participants have the ability to direct their investments among a diverse menu of options provided by the plan. They can choose how to allocate, adjust, and transfer their contributions based on their risk tolerance and investment goals at least once in any three-month period.
- **Plan sponsor fiduciary protection** | By offering a range of investment options and providing educational materials to participants, plan sponsors (you) can qualify for relief from liability for losses resulting from participants' investment decisions.
- **Diversification of investments** | The plan must offer a diversified selection of investment options (at least 3 different options that have materially different risk and return characteristics) to ensure participants have the opportunity to create a well-balanced investment portfolio suited to their individual needs.
- **Access to information** | Participants must receive sufficient information and an annual notice about the investment options available to them, including prospectuses, performance data, and fees associated with each investment option.
- **Fee transparency** | Plan sponsors are required to disclose all fees and expenses associated with the investment options offered in the plan to ensure participants understand the costs involved.

While ERISA Section 404(c) does not dictate specific asset categories, plan sponsors typically aim to provide a range of investment options across different asset classes. This helps ensure that participants have the opportunity to build diversified portfolios. Common asset categories in an investment menu of a 401(k) plan under a 404(c) arrangement may include:

Equity Funds

These funds invest primarily in stocks, offering growth potential but also higher volatility.

Fixed-Income Funds

Also known as bond funds, these investments focus on fixed-income securities and provide income generation with lower risk compared to equities.

Balanced Funds

These funds invest in a mix of equities and fixed-income securities (stocks and bonds) to provide a balanced approach to investing.

International Funds

These funds invest in securities outside the U.S., providing exposure to international markets.

Target Date Funds (TDFs)

TDFs automatically adjust asset allocation over time based on the participant's retirement date, offering a hands-off approach to investing.

Money Market or Stable Value Funds

These funds invest in short-term, high-quality debt securities and are known for their stability.

By offering a diverse range of asset categories within the investment menu, plan sponsors can help participants build well-diversified portfolios that align with their risk tolerance and investment goals while meeting the diversification requirements of ERISA Section 404(c).

Offer a Qualified Default Investment Alternative (QDIA)

A Qualified Default Investment Alternative (QDIA) serves as the default investment option for participants who do not actively make investment choices within their retirement plan accounts.

Examples of QDIAs include:

Target date funds	Balanced funds	Managed accounts	Lifetime income options	Stable value funds (up to 120 days)

By designating a QDIA, plan sponsors are allowed fiduciary protection under ERISA for participants who haven't selected investments. QDIAs ensure proper, diversified investment of contributions for non-active participants. Annually, sponsors must inform participants about the QDIA's details and opt-out procedures. QDIAs serve as suitable default investment options in defined contribution plans, aligning with retirement savings goals.

Explore different investment philosophy preferences

Beyond the investment menu categories, you should consider the specific types of investment philosophies. Below are two areas to discuss:

Index vs. active management

Determine whether participants might prefer a passive approach with index funds or an active management strategy. It is typical to have a mix of both index and actively managed investments available.

Index funds

These funds aim to replicate the performance of a specific market index, offering broad diversification at a low cost with minimal turnover.

Active management

Actively managed funds involve fund managers making investment decisions to outperform the market benchmark. They typically have higher fees and may carry higher risk.

> In general, index funds tend to have lower fees and may outperform actively managed funds over the long term, but active management offers the potential for higher returns through strategic decision-making.

Analyze various investment vehicles

Mutual funds

Mutual funds pool money from multiple investors to invest in a diversified portfolio of securities managed by professionals. They offer various types, such as equity funds, bond funds, balanced funds, international, real estate investment trusts (REITs), multi-sector, core market, and much more.

Structure and management styles: Mutual funds can be actively managed, where fund managers make investment decisions based on research and analysis, or passively managed to mirror a specific market index.

Expenses: They may include management fees, administrative costs, and other operational charges that impact the overall returns of the mutual fund.

Share classes: Evaluate how different share classes may influence investment outcomes for plan participants and consider the overall cost implications.

A shares | ***C shares*** | ***I shares*** | ***R shares***

Collective Investment Trusts (CITs)

CITs are pooled investment funds managed by a trustee or bank for the exclusive benefit of qualified retirement plans. They are not publicly traded and typically offer lower expenses compared to mutual funds.

Features and benefits: CITs provide flexibility in investment strategies, potential cost savings, and customized options tailored for retirement plans.

Considerations for plan sponsors: Plan sponsors should evaluate the suitability of CITs based on their specific plan needs, participant demographics, and desired investment objectives.

Exchange-Traded Funds (ETFs)

ETFs are securities that track indexes, commodities, bonds, or a combination of assets and trade on stock exchanges. They offer intraday trading, diversification, and typically lower expense ratios compared to mutual funds.

Characteristics: ETFs combine features of stocks and mutual funds, allowing investors to buy and sell throughout the trading day at market prices.

Cost-effectiveness: ETFs often have lower expense ratios than mutual funds, making them an attractive option for cost-conscious investors.

Working with an investment fiduciary

> You don't have to do this alone. Partner with an experienced investment professional for help.

Our firm works with plan sponsors to help craft an appropriate investment menu that follows an IPS, adheres to 404(c) guidelines and helps to the select QDIA, while supporting a diligent fiduciary approach for ongoing, thorough monitoring, documentation, and reporting.

3(21) Co-fiduciary | A 3(21) Co-fiduciary is an investment advisor who shares fiduciary responsibility with the plan sponsor. They provide investment recommendations to the plan sponsor, who ultimately makes the decisions, thus sharing the fiduciary obligations and liability for those investment decisions.

3(38) Investment Fiduciary | A 3(38) Investment Fiduciary is an investment manager who takes full discretion and control over the selection, monitoring, and replacement of plan investments within a retirement plan. They relieve the plan sponsor of liability for investment decisions made within the scope of their designated authority.

Navigating your 401(k) investment menu

When creating an investment line-up for a 401(k) plan, it's important for plan sponsors to follow a structured approach that considers the unique characteristics and benefits of each investment vehicle.

Navigating the investment menu of your company's 401(k) plan can be complex, but with the right knowledge and guidance, you can make informed decisions that benefit both your employees and the organization. By understanding the importance of a well-crafted IPS and the nuances of share investment philosophies, fund types, and share classes, you can enhance the effectiveness and compliance of your retirement plan.

Take action

For assistance in optimizing your company's 401(k) investment menu, ensuring fee reasonableness, and mitigating investment risks effectively, contact us today.

Our team of knowledgeable advisors are ready to help you navigate the world of retirement plan investments with confidence.

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