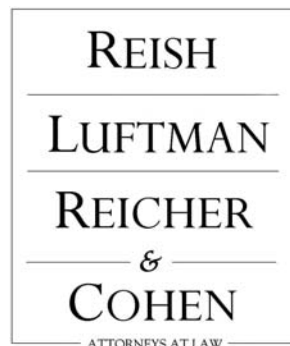
Fiduciary Duties and Obligations in Administering 457(b) Plans under California Law

A WHITE PAPER

By

Fred Reish, Bruce Ashton and Stephanie Bennett



11755 Wilshire Boulevard, 10th Floor
Los Angeles, CA 90025-1539
(310) 478-5656 / (310) 478-5831 [fax]
FredReish@Reish.com / BruceAshton@Reish.com
www.reish.com

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Fiduciary Duties and Obligations in Administering 457(b) Plans under California Law

1. *Introduction*

The purpose of this White Paper is to educate sponsors of plans formed under section 457(b) of the Internal Revenue Code of 1986, as amended ("457(b) plans") about their fiduciary duties and responsibilities under California law. The discussion will focus on duties imposed on the fiduciaries of California governmental 457(b) plans by the California State Constitution and the Government Code. Those duties are substantially identical to the fiduciary duties imposed on private sector fiduciaries by the Employee Retirement Income Security Act of 1974 (ERISA). As a result, where the California legal provisions are not developed, we will look to the well-developed regulatory and judicial authorities under ERISA to interpret the fiduciary requirements.[1]

This White Paper is organized as follows:

- We first discuss the requirements under the California Constitution regarding retirement boards of public pension and retirement systems, including the duties to:
  - act for the exclusive purpose of providing benefits to participants and beneficiaries; and
  - engage in a prudent process for making all decisions related to the operation of the plan, including decisions related to the plan's investments and services.
- We then discuss how those rules apply to fiduciaries responsible for the investment of money and/or administration of section 457(b) plans.
- Finally, we conclude by describing best practices for fiduciaries in administering 457(b) plans consistent with their obligations under California law.

[1] Government plans are exempt from ERISA. Therefore, we will analyze the federal law for guidance where the state provisions are identical or substantially similar to those under ERISA.

2. *Executive Summary*

The California Constitution provides that retirement boards (and their members) of public pension and retirement systems, including 457(b) plans, have a duty to:

- invest the assets of the plan;
- administer the plan;
- act for the exclusive purpose of providing benefits to participants and beneficiaries; and
- engage in a prudent process for making all decisions related to the operation of the plan, including decisions related to the plan's investments and related services.

The primary duty is the obligation to act for the exclusive purpose of providing retirement benefits to the participants. That is, the other duties must be fulfilled in a manner consistent with the provision of secure, yet meaningful, retirement benefits.

The conduct of fiduciaries in fulfilling that objective is measured under the prudent person standard. Although this standard is not well-developed under California law, the duty to act prudently under ERISA requires that fiduciaries make informed and reasoned decisions about all issues related to management of the plan, for example, plan investments, participant education, expenses, and plan administration. Applying these prudence requirements to California governmental plans, fiduciaries of 457(b) plans must determine the information that is relevant (or needed) to making a particular decision, gather that information, and evaluate the information − in order to make an "informed" decision. The decision must also be "reasoned," that is, the decision must bear a rational relationship to the relevant information that was reviewed by the fiduciaries. Once they have engaged in that process, the fiduciaries have a duty to take action to implement their decisions.

The prudent process requirement applies to all fiduciary decisions, including the selection and monitoring of the investments in the plan. This means that fiduciaries of 457(b) plans are required to use generally accepted investment theories and prevailing practices within the investment community when selecting or reviewing the investment options for the plan. Generally accepted investment theories include concepts such as modern portfolio theory (MPT)

and strategic asset allocation. Prevailing investment industry standards include both qualitative and quantitative analysis of the investments. Fortunately, fiduciaries are not required to be experts on those issues, but instead may rely on competent consultants – and may rely most heavily on independent advisors (that is, advisors who are not affiliated with the plan providers and/or who are not compensated through the investments that are "bought" by the plan).

The prudent person standard also requires that fiduciaries consider the circumstances prevailing from time to time. This means that fiduciaries must review their decisions periodically – to monitor the choices they previously made – to ensure that their decisions continue to be appropriate for the purpose of providing retirement benefits for the participants.

Because of the complexity of the investment process and the potential losses if imprudent decisions are made, fiduciaries are well-advised to retain the services of prudent experts (and particularly of independent experts) to assist them in the selection and monitoring of the investments.

3. *Discussion*

3.1 Fiduciary Duties under California Law

Under the Internal Revenue Code, 457(b) plans can be sponsored by governmental entities and by tax-exempt entities.[2] ERISA provides a statutory exemption for government plans, including governmental 457(b) plans, from its fiduciary and prohibited transaction provisions.[3] As a result, state law governs the fiduciary requirements for the operation and investment of 457(b) plans sponsored by governmental entities.

While ERISA does not regulate the conduct of fiduciaries of government plans, it is the most detailed, comprehensive, and developed body of law concerning the management of retirement plans. As a result, courts often look to ERISA authorities for guidance on fiduciary issues. Further, the California Constitution and Government Code place duties and obligations on fiduciaries (*e.g.,* retirement boards) that are virtually identical, in both concept and wording, to those in ERISA. Thus, to the extent the state law is not well-developed or particularly informative, this White Paper discusses guidance under ERISA.

Subsections (a), (b) and (c) of Article XVI, §17 of the California Constitution contain the provisions governing the fiduciary duties for the administration of public pension and retirement systems.[4] One obvious question is whether 457(b) plans are subject to these provisions. This is answered in Section 53609 of the Government Code, which provides that deferred compensation plans are "public pension or retirement funds" for purposes of Article XVI, §17 of the California Constitution. In particular, Section 53609 provides:

> "Notwithstanding the provisions of this chapter or any other provisions of this code, funds held by a local agency pursuant to a written agreement between the agency and employees of the agency to defer a portion of the compensation otherwise receivable by the agency's employees and pursuant to a plan for such deferral as adopted by the governing body of the agency, may be invested

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[2] IRC §457(e)(1).

[3] ERISA §4(b).

[4] Section 31476 of the California Government Code provides the definition of retirement system: "'Retirement system' means each of the systems created and established pursuant to this chapter [This chapter refers to the County Employees Retirement Law of 1937] or its predecessor. The retirement system for county employees created by Chapter 677 of the Statutes of 1937, as amended, is continued in existence under this chapter."

> in the types of investments set forth in Sections 53601 and 53602 of this code, and may additionally be invested in corporate stocks, bonds, and securities, mutual funds, savings and loan accounts, credit union accounts, life insurance policies, annuities, mortgages, deeds of trust, or other security interests in real or personal property. Nothing herein shall be construed to permit any type of investment prohibited by the Constitution.
>
> **Deferred compensation funds are public pension or retirement funds for the purposes of Section 17 of Article XVI of the Constitution."** [Emphasis added.]

Thus, if a plan includes deferred compensation funds, section 53609 would apply the requirements of Article XVI, §17 to the fiduciaries of the plan. Since 457(b) plans are deferred compensation plans for state and local governments, 457(b) plans satisfy the definition of public pension and retirement funds for purposes of the California Constitution. This means that the retirement boards, and their members, who are responsible for 457(b) plans (for ease of reference, we refer to retirement boards, committees or other responsible fiduciaries of 457(b) plans as the "board") are fiduciaries subject to the duties and obligations under Article XVI, §17.

The Constitutional provision describes the following fiduciary duties of public retirement boards:

1. The members of the board have the fiduciary responsibility for the investments of plan assets and administering the plan. The Constitution provides:

> "Notwithstanding any other provisions of law or this Constitution to the contrary, the retirement board of a public pension or retirement system shall have plenary authority and fiduciary responsibility for investment of moneys and administration of the system, subject to all of the following:
>
> > (a) The retirement board of a public pension or retirement system shall have the **sole and exclusive fiduciary responsibility over the assets** of the public pension or retirement system. The retirement board shall also have sole and exclusive responsibility to administer the system in a manner that will assure prompt delivery of benefits and related services to the participants and their beneficiaries." [Emphasis added.]

2. The assets of the plan must be held for the exclusive purpose of providing retirement benefits and defraying reasonable expenses. The duty owed to the participants takes precedence over any other duty. The language of the Constitution states:

> **"The assets of a public pension or retirement system** are trust funds and **shall be held for the exclusive purposes of providing benefits to participants** in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system.
>
> "(b) The members of the retirement board of a public pension or retirement system **shall discharge their duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries,** minimizing employer contributions thereto, and defraying reasonable expenses of administering the system. **A retirement board's duty to its participants and their beneficiaries shall take precedence over any other duty.**" [Emphasis added.]

3. The board's standard of care, as to its fiduciary duty to administer the plan, is the "prudent person" standard. This standard is described as follows:

> "(c) The members of the retirement board of a public pension or retirement system shall discharge their duties with respect to the system **with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims.**…." [Emphasis added.]

The duties imposed on the governing bodies of California public sector retirement plans, including 457(b) plans, by the California Constitution are discussed in the following sections of this White Paper.

3.2 The Exclusive Purpose Rule

Subsection (b) of Article XVI, §17 of the California Constitution provides that fiduciaries must act for the exclusive purpose of providing benefits to participants and beneficiaries. This is referred to as the exclusive purpose rule.

In 1992, Article XVI, §17 was amended by Proposition 162, which added the last sentence to subsection (b) indicating that a "retirement board's duty to its participants and their beneficiaries shall take precedence over any other duty." Prior to the addition of that last sentence, the three duties of providing benefits to participants, defraying reasonable expenses of administration and minimizing employer contributions were of equal importance. The addition of this sentence clarified that the "exclusive purpose" requirement, to provide benefits to members of the retirement system, has priority over a retirement board's other obligations.

This interpretation echoes the interpretation of the exclusive purpose rule under ERISA. The U.S. Department of Labor (DOL) (the federal agency authorized to interpret and enforce the provisions of ERISA) has explained:

> "The Department has construed the requirements that a fiduciary act solely in the interest of, and for the exclusive purpose of providing benefits to, participants and beneficiaries **as prohibiting a fiduciary from subordinating the interests of participants and beneficiaries in their retirement income to unrelated objectives**."[5] [Emphasis added.]

Consistent with Article XVI, §17 of the California Constitution, the Government Code §53216.6 provides that the assets of a public retirement system are trust funds and should be held for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the pension system. That section reads as follows:

> "The assets of the pension trust are trust funds and shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system.
>
> "The legislative body, trust, or other body authorized to make investments for a pension trust, shall discharge its duties with respect to investing the assets of the pension trust:
>
> "(a) **Solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the trust**." [Emphasis added.]

[5] DOL Interpretive Bulletin 94-1

In light of these "exclusive purpose" requirements, every action that fiduciaries (*i.e.*, members of retirement boards) take and every decision that they make must be consistent with that purpose. Thus, the exclusive purpose rule establishes the fiduciary objective; that is, providing retirement benefits for the participants.

In order to meet this objective when making decisions regarding the plan, such as investment selection, the board must focus on the goal of accumulating retirement savings. As stated earlier, this duty takes precedence over other duties and considerations. For example, a board cannot prioritize other benefits or payments, or the interests of other parties, over the interests of the participants. To do so would be a fiduciary breach. As another example, board members, as fiduciaries, must diligently and rigorously evaluate the plan and investment expenses and pay no more than is reasonably required for the successful operation of the plan. The failure to gather and evaluate the expense information is also a breach of fiduciary responsibilities. As a practical matter, fiduciaries need to obtain information from the marketplace about the expenses charged by 457(b) providers in order to understand and compare expenses.

In the case of 457(b) plans, in which the individual participants direct the investments, although participants can decide which of the offered investments to use, they cannot decide which investments are available; that is the job of the board. Thus, in evaluating investments, the board must select, monitor and dispose of investments for the exclusive purpose of providing retirement benefits. The board's conduct in fulfilling this objective is measured under the prudent person standard, which requires that the board act with "care, skill, prudence and diligence" and make informed and reasoned decisions, as discussed in the next section.

3.3 Prudent Person Rule

Subsection (c) of Article XVI, §17 of the California Constitution contains the "prudent person" requirement by which the conduct of the board members in fulfilling the exclusive purpose requirement is measured. The prudent person rule in the California Constitution has a number of elements:

- It requires that fiduciaries of 457(b) plans act with "care, skill, prudence, and diligence."

- It requires them to do so in the context of the "circumstances then prevailing."
- It requires that they do so in the same way that "a prudent person acting in a like capacity and familiar with these matters would use."
- It requires that these steps be taken in connection with the "conduct of an enterprise of a like character and with like aims."[6]

Unfortunately, California law is not well-developed in terms of either case law or administrative guidance, regarding fiduciary responsibility issues under the California prudent person standard. Fortunately, other than a substitution of the word "person" for the word "man," the language of the prudent person rule under the California Constitution is identical to the prudent man rule under ERISA. Thus, in order to provide meaningful guidance to fiduciaries of 457(b) plans, we are able to refer to DOL guidance and case law interpreting ERISA.

The DOL has described the steps that a fiduciary must take in fulfilling the prudent man rule, with regard to investments, as follows:

> "the requirements of the [prudent man rule] are satisfied if the fiduciary (A) has given **appropriate consideration to those facts and circumstances** that...the **fiduciary knows or should know are relevant to the particular investment** or investment course of action involved...and (B) **has acted accordingly**."[7]

Thus, the prudent man rule requires fiduciaries to be prudent both substantively and procedurally. As indicated in the DOL regulation, fiduciaries need to determine what information is material and relevant to making a particular decision; they must gather that "relevant" information; they must examine and understand the information; and then they must make an informed and reasoned decision.[8] In the context of investments, the fiduciaries must understand generally accepted investment principles and prevailing investment industry practices,[9] which form the "backbone" of a prudent process for investment decisions. Therefore, fiduciaries must engage in a process of determining and gathering the data relevant to make an informed decision

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[6] CA Const. Article XVI, §17(c)
[7] DOL Regulation Section 2550.404a-1(b)(1).
[8] *See, e.g.*, DOL Reg. §2550.404a-1(b); 29 CFR 2550.404a-1(b).
[9] DOL Interpretive Bulletin 96-1

and of evaluating that information to make a reasoned decision. Fiduciaries may use competent consultants and advisors to assist them in fulfilling that standard (*see* Part 3.5 of this White Paper).

Below is a list of factors fiduciaries (such as boards of 457(b) plans) should consider in fulfilling their duty to engage in a prudent process for making decisions:

1. The board must determine which "facts and circumstances" are relevant to making a decision on the issue (*e.g.*, the investments or services to be offered to participants).

2. The board then must gather the relevant information. The collected information must include not only what the board "knows" is significant to the decision, but also what the board "should know" is relevant. The "should know" requirement creates an obligation on the board members to either investigate the issues and facts themselves or to hire an experienced and knowledgeable advisor in order to fully understand the issues and to gather the information that is relevant to the decision.

3. The board must then give "appropriate consideration" to the relevant information. That is, they must review and evaluate the relevant information in order to make a decision that is informed. As part of this process, they may engage experts to assist them in the analysis, but they must prudently select the experts and evaluate their advice; they may not rely "blindly" on their advisors. However, as a practical matter, if the advisors are well-qualified, then the board may place great weight on their recommendations.

4. The board must then reach a decision on the basis of the analysis they have undertaken and the assessment they have made of the information they have considered and the advice they have received. This is the essence of a "reasoned" decision.

5. Finally, the board must implement that decision.

The steps in this process are orderly and logical. While these steps require that board members take a diligent and disciplined approach to managing the plan, they are not overly burdensome. Nevertheless, they do require a level of expertise – expertise in selecting investments and services that will produce meaningful retirement benefits in the context of a participant-directed plan, taking into account the unique needs of the employees covered by the plan. Thus, the key to the prudent process is deciding on and gathering the information that a prudent and knowledgeable fiduciary would determine is needed in order to make an informed and reasoned

decision. And, where the rules require the collection and analysis of data, boards may substantially reduce that burden by working with competent advisors.

3.3.1 Prudence Regarding Plan Investments

As stated in Article XVI, §17 of the California Constitution,

> "the retirement board of a public pension or retirement system **shall have plenary authority and fiduciary responsibility for investment of moneys** and administration of the system…"[Emphasis added.]

As the highlighted language indicates, boards have the "fiduciary responsibility" for the investment of assets and the administration of the plan. In discharging their duties to invest the assets of the plan, boards must act in accordance with the "exclusive purpose requirement," which means that a board must prudently manage investments for the exclusive purpose of accumulating retirement benefits for the participants. As explained in a previous section, the prudent person standard requires that the board engage in a prudent process in making decisions. This prudent process requirement applies to both the selection and monitoring of the investments offered by a plan and for how those investments are actually used by the participants (*see,* Part 3.5). And, when handling those duties, board members must keep in mind that the decisions, including the investment decisions, must be made with an eye to whether they are effective in terms of producing retirement benefits.

The California Constitution also notes that boards have plenary authority for the investment of plan monies. Courts have been careful to point out that the "plenary authority" granted to boards is not an unchecked power. As one court explained, "Plenary power does not mean un-reviewable power."[10] Thus, although boards have plenary authority and fiduciary responsibility over the investments and administration of plans, such duties and obligations are subject to judicial review and oversight.

Based on both legal guidance and our observations of the practices of fiduciaries, the primary investment duties for fiduciaries of participant-directed plans are:

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[10] *Board of Retirement v. Santa Barbara County Grand Jury*(1997) 58 Cal.App.4th 1185, 1193; *See also, Singh v. Board of Retirement* (1996) 41 Cal.App.4th 1180, 1190.

- The development of an investment policy for the plan.
- The selection of the investment alternatives to be offered to the participants.
- The selection of investment services for the participants.
- The selection of a "default" investment.
- The selection of advisors if the fiduciary desires assistance or does not have the relevant expertise.
- The monitoring and, if necessary, the removal of investment options.

Each of those activities is a fiduciary act. As such, each must be done according to the prudent person standard – which means that the board must engage in a prudent process to consider and decide each issue. They must review the right information in the right way and reach a reasoned decision. Or, alternatively, they must seek outside help.

Looking to the ERISA requirements related to investments, fiduciaries are required to use generally accepted investment principles, including modern portfolio theory, and prevailing practices within the investment community to establish a plan's investment policies and to select the investment options.[11] By "generally accepted investment theories," we are referring to the fundamental principles underlying modern concepts of proper investing. These include modern portfolio theory and strategic asset allocation – looking at an investment portfolio as a whole and taking into account diversification within the portfolio. When this guidance is applied to a board, the members of the board must ensure that the number and types of investments are adequate to allow participants to use those investments to properly balance risk and reward according to their individual needs.

For example, in establishing the plan's investment policy, the board would need to select investment classes in various equity and debt categories that would permit the creation of well-diversified portfolios at the participant level.

If the board does not have a grasp of these theories and principles, it will be difficult, if not impossible, for its members to prudently select the investments to be offered for participant direction. In those situations the board should consider selecting an advisor, especially since the

[11] DOL Interpretive Bulletin 96-1.

duties of board members do not end with the selection of the investments. Instead, those duties include an ongoing duty to monitor the investments. This duty to monitor is discussed below.

3.4 **The Duty to Monitor**

In light of the requirement under the prudent person standard that fiduciaries take into account the "circumstances then prevailing," boards have an ongoing duty to periodically review the investments and services offered by the plan and to decide whether their initial decisions remain valid in light of changed circumstances. In describing the obligations of fiduciaries, the courts have said that "ERISA fiduciaries must monitor investments with reasonable diligence and dispose of investments which are improper to keep."[12] And again: "Once an investment has been made, a fiduciary has an ongoing duty to monitor investments with reasonable diligence and remove plan assets from an investment that is improper."[13]

This means that fiduciaries have a duty to remove specific investments when, under the prudent person standard, they should no longer continue to be available as investment options for participants. It states by the DOL:

> "Thus, for example, in the case of look-through investment vehicles, the plan fiduciary has a fiduciary obligation to prudently select such vehicles, as well as a residual fiduciary obligation to periodically evaluate the performance of such vehicles to determine, based on that evaluation, whether the vehicles should continue to be available as participant investment options."[14]

This means that it is not enough for the members of the board to act prudently and in the best interests of the participants in the initial selection of investments. They must periodically review their decisions, gather more relevant information and go through a process of monitoring the performance of the selected investments to determine whether to reaffirm or change their original decision.

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[12] *Morrissey v. Curran*, 567 F.2d 546, 548-49 (2d Cir. 1977).
[13] *Harley v. Minnesota Mining and Manufacturing Company*, 42 F.Supp.2d 898, 906 (D.Minn. 1999).
[14] Preamble to ERISA 404(c) regulation 57 FR 46924 FN.27.

3.5 Delegation of Investment Direction to Participants

As discussed above, the California Constitution and the Government Code provide that the basic fiduciary responsibility of the board in selecting investments is to engage in a prudent process. That process includes an appropriate investigation of the investments, prudent selection of the investments that are to be offered to the participating employees, and the selection of advisors to help in the process.

In our experience, 457(b) plans almost universally delegate investment direction to the participants. That is, while the board members, as fiduciaries, select the investment options for the plan, the participants decide which investments to actually use in their accounts. In that regard, the law contemplates that, consistent with modern portfolio theory,[15] the participants will select from among the investment options to craft portfolios in their accounts which balance their needs for return with their tolerance for risk.[16]

The California Government Code recognizes that the board may delegate control over the use of the investments to the participants. However, the Government Code also requires that, for the fiduciaries to avoid liability for potential imprudent investment decisions by the participants, the board must satisfy a number of conditions:

> "Notwithstanding any other provision of law, participants choosing individually directed investments shall relieve the trustee and local agency of responsibility under the terms of the plan and trust**. That relief shall be conditioned upon the local agency compliance with communication and education requirements similar to those prescribed in subdivision (c) of Section 1104 of Title 29 of the United States Code for private sector employers**."[17] [Emphasis added.]

The provision of federal law referred to in that section is also known as ERISA Section 404(c). Section 404(c) provides that fiduciaries of a retirement plan are relieved of liability for losses that are the direct result of a participant's exercise of control over his account . . . if certain requirements are met.

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[15] *Laborers Nat. Pension Fund v. Northern Trust Quantitative Advisors, Inc*., 173 F.3d 313 (5th Cir 1999). *See, also, In re Unisys Sav. Plan,* 1997 WL 732473 (ED Pa), *Chao v. Moore,* 2001 WL 743204 (D Md), and *In re Enron Corp. Securities,* 2003 WL 222245394 (SD Tx); DOL Regulation 29 CFR §2509.96-1.
[16] DOL Regulation 29 CFR 2550.404c-1(b)(2)(i)(B)(1)(ii).
[17] Ca. Govt. Code § 53213.5(b)

It is important to note that the relief offered to fiduciaries under Section 404(c) of ERISA is limited, because participant investments in a participant-directed plan are limited to the investment options selected by the plan fiduciary. As the DOL has stated:

> "All of the fiduciary provisions of ERISA remain applicable to both the initial designation of investment alternatives and investment managers and the ongoing determination that such alternatives and managers remain suitable and prudent investment alternatives for the plan. Therefore, the particular plan fiduciaries responsible for performing these functions must do so in accordance with ERISA."[18]

The DOL has issued a regulation under Section 404(c) (referred to as the 404(c) regulation) discussing the conditions that must be satisfied for the relief from liability granted by that section to be available. In general, the requirements are that the plan provide the participants with an "opportunity to exercise control" and an opportunity to select from a broad range of investment options. There are roughly 20 more detailed requirements in the regulation that must be met in order for fiduciaries to be relieved of liability for losses resulting from participants' exercise of control over their accounts. In general, the requirements relate to the information that must be provided to participants in order for the participants to make informed investment decisions and the disclosure of restrictions that may be imposed on the participants' ability to exercise control over their accounts.

In considering the application of the requirements under the section 404(c) regulation to a 457(b) plan, it is important to note that Government Code Section 53213.5 states that the governing body or trustee will be relieved of liability if the plan complies with requirements "similar" to those imposed by ERISA section 404(c). Although it is not entirely clear what is contemplated by the use of "similar," it appears that substantial compliance with the conditions of the 404(c) regulation would be required.

As a word of warning, our experience is that few boards of California 457(b) plans are aware of this provision. As a result, almost none are complying with the 404(c) conditions. Because of that failure, most boards, and their members, are responsible, as fiduciaries, for the prudence of

[18] Preamble to ERISA 404(c) regulation 57 FR 46922.

the investment decisions made by the participants. (This is in addition to the responsibility for the selection and monitoring of the investments offered to the participants.)

With that in mind, to avoid liability for potential imprudent investment decisions by the participants, boards for California 457(b) plans should comply with the 404(c) requirements with assistance from providers, advisors and benefits lawyers. Additionally, boards should work with their advisors and providers to assist participating employees in prudently investing their accounts, for example, through the use of asset allocation models, age-based lifecycle funds and risk-based lifestyle funds and through investment education advice.

4. *Best Practices*

Although not an exhaustive list, the following is a summary of best practices that boards of 457(b) plans should consider:

Practice No. 1: Hold quarterly or semi-annual meetings with consultants, providers and other advisors (such as benefits attorneys) to review information about the operation and investment activities of the plan and to evaluate methods for improvement. Report to their appointing authority regarding the board's activities at least once a year.

Practice No. 2: Prudently select the investment options (including the default investment option) to be offered by the plans offered to participants:

- The options should constitute a broad range of investment categories;
- The options should be prudently selected and monitored (which includes removing and replacing investment options that are performing poorly); and
- Options should be suitable and appropriate for the participants.
- The investment considerations and decisions should be based on generally accepted investment theories and prevailing investment industry practices. Competent advisors should be engaged to assist in understanding and applying these principles.

Practice No. 3 Prepare an Investment Policy Statement for the Plan.

Practice No. 4: Establish a process designed to monitor the performance of the investment options in accordance with the criteria and benchmarks set forth in the Investment Policy Statement.

Practice No. 5: Prudently select independent, competent advisors to assist the board. Once the advisor is selected, monitor the performance of the advisor, and remove and replace the advisor if it fails to perform adequately or properly.

Practice No. 6: Document activities including the process of selecting and monitoring investments, because regardless of the process used, the fiduciary should be able to demonstrate compliance with the legal standards.

Practice No. 7: Comply with the requirements under ERISA section 404(c) to obtain relief for the board for liability for losses that are the direct result of a participant's exercise of control over his account.

5. *Conclusion*

The fiduciary duties imposed on a board with respect to a 457(b) plan of a governmental unit under California law are significant and are similar to the duties and obligations of ERISA fiduciaries. Thus, boards have an obligation to prudently perform their duties for the exclusive purpose of providing retirement benefits to participants and beneficiaries. This obligation encompasses a number of separate tasks, including:

- To act for the exclusive purpose of providing retirement benefits to participants. This obligation takes precedence over all other duties.
- To comply with the law's prudent person standard when carrying out their duties. This duty requires board members to engage in a prudent process when making decisions.
- To prudently select and monitor the investment alternatives offered under the plan. This duty requires that the members of the board develop criteria and policies for selecting investments. The chosen investment options should: constitute a broad range of investment categories; be prudently selected and monitored (which includes removing and replacing investment options that are performing poorly); and be suitable and appropriate for the participants.
- To seek help from competent consultants and advisors.

In addition, boards of 457(b) plans should obtain relief similar to that offered under section 404(c) of ERISA as protection from imprudent participant investment decisions. However, that relief is limited to losses that are the direct result of a participant's exercise of control over his account. Thus, even in those situations, boards remain responsible for the prudent selection and monitoring of the investment options in the plan. Therefore, boards of 457(b) plans should consider adopting practices similar to the "Best Practices" described in this White Paper.