

401(k) Adviser Due Diligence

February 14, 2008

On February 2, 2007 the Department of Labor released guidelines for all advisers who receive compensation for services to ERISA plans. These guidelines were included in the Field Assistance Bulletin (FAB) 2007-01.

The guidance applies to all advisers and requires plan sponsors to maintain documentation of an objective process of adviser selection and adviser monitoring. Separate guidelines are provided for the selection process and for monitoring.

This guide is intended to assist plan sponsors and advisers to comply with these guidelines and to describe the ways in which DALBAR's Adviser Monitor Program has been enhanced to simplify the process of meeting the guidelines.

Obtain an application for DALBAR ADVISER MONITOR at:

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FREQUENTLY ASKED QUESTIONS

WHO MUST COMPLY?

Any plan sponsor that uses an adviser who is compensated directly or indirectly to analyze or recommend plan investments or investments for participants. Plan sponsors must have documented evidence of an objective process of selection and monitoring.

WHAT DO PLAN SPONSORS NEED TO DO?

Plan sponsors have three choices, either:

- Conduct their own objective process to evaluate the advisers they currently use and prepare the documentation to evidence compliance or...
- Use an independent third party (such as the DALBAR Adviser Monitor) to conduct the objective process and prepare the required documentation or...
- Ask the adviser to have the objective process conducted by an independent third party (such as the DALBAR Adviser Monitor) and supply the required documentation.

WHEN IS SELECTION PROCESS REQUIRED?

The objective selection process should be performed before the adviser is compensated. If the objective selection was not performed in the past, it is suggested that an evaluation is done and documentation prepared as soon as possible for advisers who are currently engaged.

WHEN IS MONITORING REQUIRED?

The requirement is for the monitoring to be “periodic”. A prudent approach would include continuous monitoring for significant changes or failures in combination with a formal documented annual monitoring review.

HOW IS THE DALBAR ADVISER MONITOR PROGRAM ACCESSED?

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BACKGROUND

The Field Assistance Bulletin (FAB) 2007-01 has defined compliance standards required for plan sponsors and advisers. Under FAB 2007-01 plan sponsors are required to have documentation of an objective process used to select and monitor of all investment advisers. FAB 2007-01 defines investment advisers as anyone that:

“renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of a plan, or has any authority or responsibility to do so.”

Under FAB 2007-01 plan sponsors must select and then monitor advisers who:

- Develop investment policies, selects vendors and investment line-ups or
- Monitor investment performance and recommends changes to line-ups or
- Provide investment advice to plan participants.

The minimum standards defined in FAB 2007-01 for selection and monitoring are:

For Adviser Selection

“... an objective process that is designed to elicit information necessary to assess the provider’s qualifications, quality of services offered and reasonableness of fees charged for the service. The process also must avoid self dealing, conflicts of interest or other improper influence.”

“will take into account the experience and qualifications of the investment adviser, including the adviser’s registration in accordance with applicable federal and/or state securities law, the willingness of the adviser to assume fiduciary status and responsibility under ERISA with respect to the advice provided to participants, and the extent to which advice to be furnished to participants and beneficiaries will be based upon generally accepted investment theories.”

For Adviser Monitoring

“...periodically review, among other things, the extent to which there have been any changes in the information that served as the basis for the initial selection of the investment adviser, including whether the adviser continues to meet applicable federal and state securities law requirements, and whether the advice being furnished to participants and beneficiaries was based upon generally accepted investment theories.”

“take into account whether the investment advice provider is complying with the contractual provisions of the engagement; utilization of the investment advice services by the participants in relation to the cost of the services to the plan; and participant comments and complaints about the quality of the furnished advice. With regard to comments and complaints, we note that to the extent that a complaint or complaints raise questions concerning the quality of advice being provided to participants, a fiduciary may have to review the specific advice at issue with the investment adviser.”

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SPECIFIC GUIDELINES

REQUIREMENTS FOR OBJECTIVE ADVISER SELECTION

	Evaluation Required for Adviser Selection	Method of Assessment Used by the DALBAR ADVISER MONITOR PROGRAM
1	Qualifications	Qualifications include three areas: 1. Knowledge of investments and ERISA 2. Experience as an adviser 3. Past record of service and financial results
2	Quality of services	Quality of the adviser's services is determined from the opinions of a representative sample of adviser's clients.
3	Reasonableness of fees*	Adviser is asked to disclose fees, which are then compared to fees paid to advisers with comparable qualifications for comparable services.
4	Self dealing*	Adviser is asked to disclose contractual arrangements and an independent determination is made if there are failures to disclose.
5	Conflicts of interest*	Adviser is asked to disclose sources of compensation and an independent determination is made if there are failures to disclose.
6	Other improper influence	Adviser is asked to disclose any additional personal relationships (family, friends, etc.) or other factors that might influence investment selection and an independent determination is made if there are failures to disclose.
7	Securities registration	Adviser's registration is verified with applicable regulators to determine status and existence of reported incidents.
8	Willingness to assume fiduciary status	Adviser is asked to declare responsibility as a fiduciary in writing.
9	Investment theories used*	Adviser is asked to describe the investment theory that will be applied and a determination is made if this theory is generally accepted within the investment community.
* Indicates items added in response to Department of Labor guidance in FAB 2007-01		

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REQUIREMENTS FOR PERIODIC ADVISER MONITORING

	Evaluation Required for Adviser Monitoring	Method of Assessment Used by the DALBAR ADVISER MONITOR PROGRAM
1	Changes in basis for selection	Pro-active reexamination of all nine factors used in selection is performed annually.
2	Compliance with the contractual provisions of the engagement	Compare terms of engagement to experience of participants and others served by the adviser and that investment theory has been consistently applied.
3	Utilization in relation to the cost*	Measure the utilization cost by dividing the total cost of adviser by the number of participants who implemented that adviser's advice.
4	Participant comments and complaints about the quality of the furnished advice*	Determine if the level of participant satisfaction and number of complaints is in line with norms for comparable periods.
* Indicates items added in response to Department of Labor guidance in FAB 2007-01		

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THE DALBAR ADVISER MONITOR

PROGRAM COST

The costs shown are per adviser for initial selection and annual monitoring by the DALBAR ADVISER MONITOR PROGRAM. The cost is based on the number and category of advisers plus out of pocket costs for mailing.

Adviser Category	Initial and Annual Cost Per Adviser		
	1 - 9 Advisers	10 - 99 Advisers	100+ Advisers
<u>Plan Adviser:</u> Advisers engaged to develop investment policies, select vendors and investment line-ups or to monitor investment performance and recommend changes to investment line-ups.	\$1,500	\$1,250	\$950
<u>Participant Adviser:</u> Advisers whose only duties are to advise participants with investment matters.	\$1,000	\$900	\$600
<u>Associate Adviser:</u> Advisers that work under the supervision of a plan adviser or a participant adviser.	\$500	\$450	\$300

OBJECTIVE SELECTION STEPS

For Plan Sponsors

A plan sponsor conducting the required objective selection notifies the adviser(s) and submits a plan sponsor application listing each adviser that will undergo the selection process.

For Advisers

Advisers complete an adviser application, which includes certain declarations and disclosures. Background checks are performed based on the information provided. Adviser is notified of any unfavorable results and has an opportunity to respond with additional documentation.

Plan advisers and participant advisers are asked to describe the investment theories used in providing advice. Each description is evaluated against existing investment theories to determine if the standard of being “generally accepted” is met. Adviser is notified of any unfavorable results and has an opportunity to respond with additional documentation.

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Adviser provides a complete list of current clients, including plan sponsors and individual clients. Clients are selectively contacted and asked to give a confidential evaluation of the adviser's past record and the quality of service provided. Adviser is notified of any unfavorable results and has an opportunity to respond with additional documentation.

Adviser is given a supervised test to establish baseline knowledge of ERISA and investing principles.

Adviser is provided with formal results of the process that is then presented to the plan sponsor.

PERIODIC MONITORING STEPS

For Plan Sponsors

Plan sponsors use and advise employees to use complaint hot line to report any problems with an adviser. These are reviewed immediately to determine if the complaint is severe. If not severe a record is maintained and used in the next formal review.

Plan sponsors may use the annual employee survey that is provided as a part of the monitoring component. If used, plan sponsor is responsible for only out of pocket costs for mailing.

For Advisers

Advisers disclose any changes that are pertinent to their role when they occur. These are reviewed immediately to determine if the change is requires action. If no immediate action is required a record is maintained and used in the next formal review.

Adviser files an annual report that includes changes, utilization of services and compensation. This is reviewed in addition to client experiences and complaints received.

Adviser is provided with formal results of the process that is then presented to the plan sponsor.

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