



# **A Review of the Ibbotson Advisory Solution in TIAA-CREF ‘Direct Offer’ 403(b) Plan Architectures**

BCM Retirement Solutions  
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*Our current disclosure document is set forth on Part II of Form ADV and is available for your review upon request.*

## **Regulatory Overview**

Over the past several years there has been a growing awareness among retirement plan sponsors and trustees of their fiduciary obligations. Helped along considerably, no doubt, by the increasing scrutiny of those obligations by the DOL and IRS subsequent to the 2006 Pension Protection Act. While these fiduciary obligations are not new, the scrutiny level on their diligent execution has increased significantly. The number of DOL and IRS audits have been on an upward trajectory for several years now, as the number of auditors employed at those agencies has grown by leaps and bounds. This scrutiny has even fallen on the “small plan” level. Those agencies have made clear that small plans can no longer be assured of avoiding these issues by virtue of simply being “too small to notice.”

Many non-profits choose TIAA-CREF to implement their organization’s retirement plan. A prudent step, but many organizations mistakenly believe that because of TIAA-CREF’s size and reputation that the fiduciary tasks are being managed for them by TIAA-CREF. This would be a critical mistake as TIAA-CREF is explicit in documenting that they are NOT a plan fiduciary. They never were and they are unlikely to ever accept such a role directly in the future. The potential liability for accepting a fiduciary role with every single one of their clients would be prohibitive for them, as you can well imagine.

Still, TIAA-CREF realizes that their clients are going to ask for increasing levels of fiduciary support over time for the reasons stated above. And one of the most important fiduciary duties that sponsors and trustees are obligated to is the selection and monitoring of the plan’s investment offerings. In the new TIAA-CREF “Direct Offer” architecture, with its vast array available investment choices, this considerable obligation can not be taken lightly. However, TIAA-CREF can NOT make or even suggest the choices for you without risking becoming a fiduciary under the DOL’s “functional fiduciary” definition.

So how do you give investment advice to your client when you are not allowed to give investment advice to your client?

### **Enter Ibbotson Associates: “Mail-Order” Co-Fiduciary**

To address this situation TIAA-CREF has made arrangements with Ibbotson Associates, an outside investment advisory firm willing to take on a limited-scope co-fiduciary role to plans and their sponsors/trustees. Their service is offered as an optional “product feature” in the Direct Offer platform. Ibbotson, if retained by the plan sponsor, will make suggestions on the investment line-up offered in the plan, monitor those funds on an ongoing basis and make further recommendations to the sponsor when they felt it is appropriate to add, remove or replace a fund. They accept limited-scope 3(21) co-

fiduciary status for their recommendations only. They charge a fee of 3bps of plan assets per year for this service.

On the surface, this would seem to be an ideal solution for all involved. Plan sponsors get a limited-scope co-fiduciary level investment advisor to their plan while TIAA-CREF can maintain their customary non-fiduciary role as merely the plan platform provider.

This mail-order fiduciary solution runs into potential issues when it is applied in the real world, however. There are a number of reasons for this. One is based in the legal definition of an ERISA-recognized fiduciary while there are also several functional drawbacks.

### **How ERISA And the DOL See the Solution:**

There are multiple levels of fiduciary responsibility recognized under ERISA. The highest level is always the plan sponsor's- the Named Fiduciary of the plan. This fiduciary (or fiduciaries, if handled by multiple people or a committee) bears ultimate responsibility for the plan and its governance- to be managed for the EXCLUSIVE benefit of plan participants. However, ERISA also recognizes that running a plan is a large and complicated task, so they provide ways that the plan sponsor can enlist help, including sharing some of their fiduciary obligations with competent outside parties. Enlisting the help of an investment advisor as a co-fiduciary to the plan is a natural area for a typical small plan sponsor (most of whom are not investment professionals) to seek help.

The amount of that fiduciary responsibility that can be transferred to a third party advisor is based on the type of ERISA co-fiduciary role that third party is willing to accept. There are two levels of investment advisors: 3(21) advisors and 3(38) advisors. (There are also 3(16) level advisors but those are outside the scope possible in a TIAA-CREF plan structure.)

The lowest responsibility-sharing level of the two is the 3(21) investment advisor. This is the fiduciary level which Ibbotson accepts. As such an advisor, they offer SUGGESTIONS and RECOMMENDATIONS to the plan sponsor on the plan's investments. *It is still the responsibility of the plan sponsor to appropriately review those recommendations in context, approve them and implement those decisions.* Because of this, little in the way of fiduciary liability exposure is transferred to Ibbotson. A 3(38) level co-fiduciary, by comparison, manages those tasks directly and with discretion on behalf of the plan sponsor and accepts a much greater share of the fiduciary liability exposure. In brief:

- 3(21) level advisor: Ibbotson's co-fiduciary level. Provides investment recommendations only and is, therefore, only held responsible for making good recommendations. Less fiduciary liability exposure is transferred to the advisor.

- 3(38) level advisor: BCM’s co-fiduciary level. Manages plan investments directly and with discretion on behalf of the plan sponsor. Responsible for proper review, monitoring, and implementation of those investment decisions within the plan. More fiduciary liability exposure is transferred to the advisor.

Many good articles and white papers have already been written comparing different fiduciary (and non-fiduciary) level advisors that go well beyond the scope of this paper. Some are as close as a quick Google search. We would also be happy to furnish you with additional information if you would like to read more on the subject.

### **Where the Rubber Meets the Road: The Real World**

The other area where there are potential shortcomings of the Ibbotson solution lie in the reality of implementing, managing and paying for that service. Of immediate concern to existing TIAA-CREF legacy plan sponsors is the pricing structure. At only 3 bps of plan assets per year it would seem the pricing would be well down the list of potential drawbacks. However, the way those costs are calculated and apportioned makes justifying its implementation potentially problematic.

The 3 bps cost is calculated against ALL plan assets- not just on the new Direct Offer platform assets. If there are old (legacy) TIAA-CREF contracts, the assets in those contracts are counted towards Ibbotson’s fee calculation. Let’s take the example of a \$30MM legacy TIAA-CREF plan with \$2MM in yearly contributions that wants to implement a new Direct Offer platform for all future contributions and participants. The Ibbotson fee for that plan would be:

Plan Year	New Direct Offer Assets	Total Plan Assets	Ibbotson Rate	Total Ibbotson Fee	Effective rate against new Direct Offer assets
1	\$2,000,000	\$32,000,000	3 bps	\$9,600	48 bps
2	\$4,000,000	\$34,000,000	3 bps	\$10,200	25 bps
3	\$6,000,000	\$36,000,000	3 bps	\$10,800	18 bps

It is important to understand that the full Ibbotson yearly fee amount can only be charged against the assets in the new Direct Offer platform. It can not be charged against the assets in the legacy contracts (where the bulk of the assets driving that fee number exist in the first place). So, in year one, there would be a \$9,600 fee against only \$2MM in assets in the new Direct Offer platform by the end of year one. That translates into 48 bps in fees, all of it paid by the new contributions and participants. TIAA-CREF often gets push-back from their clients and many choose not to implement it when they see how that simple “3 bps fee” explodes to a much higher number, and only

on certain participants, if you are trying to implement a new contract. You can now understand why the push-back is commonplace.

Furthermore, since most legacy TIAA-CREF contracts are individual contracts, there is no way to force participants to move to the new Direct Offer platform to assure rapid asset expansion. In short, a very large fee could well be laid against a very small amount of assets.

Other potential shortcomings of the Ibbotson fiduciary solution stem from the fact that they are operating at a distance and in “suggest-only” capacity. *All investment add/remove/change recommendations are still the responsibility of the plan sponsor and trustees to review, approve and implement* (as discussed above in the ERISA fiduciary section). This approval can not be given at the level of a plan’s day-to-day administrator since this is clearly a fiduciary-level duty. As such, that approval must come from the organization’s Named Fiduciary, Board or Retirement Plan Committee. Not only does this add extra steps to the overall plan workload, it introduces potentially significant delays in implementing the recommended investment changes.

In the area of investment selection it is also important to recognize Ibbotson is making the same fund recommendations for all TIAA-CREF Direct Offer plans they advise. All Direct Offer clients receive the same recommended fund list. If there are additional asset classes that you would like to open up to your participants that aren’t on the Ibbotson recommended list, they will not add them for you as a one-off, nor take fiduciary responsibility if you decide to include them on your own. Even a fairly simple fund selection request like “we would prefer to use more index funds” cannot be easily accommodated. Flexibility is limited.

That being said, there are organizations where the Ibbotson solution could be a very good fit. Those would typically be organizations that already possess certain capabilities and expertise in-house. Having an expert retirement plan committee- a dedicated committee just for the plan (a sub-committee under Finance, or a completely separate committee being typical structures) would be an important minimum requirement. That committee would have a defined tool set or methodology to independently evaluate Ibbotson’s investment recommendations with expertise, prior to approval and implementation. Having a committee member (or members) with a thorough understanding of ERISA compliance would also be highly advisable. An ERISA attorney on the committee would be the ‘gold standard’ in that respect, but probably too much to hope for in most organizations. And, of course, the transition from legacy TIAA-CREF contracts would need to be well planned in advance to make sure the unusual way the Ibbotson solution is priced (as explained above) does not result in unexpected or excessive fees impacting different groups of participants in different ways.

## **Additional Considerations**

Many non-profit institutions often find that the regulator environment is rapidly changing at a pace that seems daunting. The new regulations wave is caused by the push to bring 403(b) plans into parity with 401(k) plans, as it relates to the ERISA compliance functions. The basic steps have been adopted by most institutions by now and there is a concerted effort to bring better adherence to fiduciary best-practices. Proper fiduciary investment review and monitoring is, obviously, a very important one, as we discussed at the top of the article.

However, it is not the ONLY fiduciary duty. And in addition to these fiduciary duties there is also a vast amount of management-level compliance work that most non-profit institutions do not understand or have not implemented. Unfortunately, most of the tasks that are being missed are also the tasks that are most often the reasons for fiduciary breach litigation.

A thorough understanding of the entire scope of both fiduciary-level and compliance-level obligations is required. A good ERISA-savvy advisor should demonstrate a strong ability to assist, advise and guide you in all aspects of good plan governance. In short, look before you leap into arrangements that only address a single point of plan concern. A more comprehensive view of good governance will almost always yield a plan of much higher quality in every aspect.

*Damon Nickle is a retirement plan specialist with BCM Retirement Solutions. He has helped many non-profit institutions improve their retirement plan compliance and quality. His retirement plan management focuses on total plan success - for the plan sponsor and the participants. Having a unique understanding of the TIAA-CREF program allows his clients to retain the best of TIAA-CREF services and support and integrate the compliance functions and improve investment quality to produce better results for participants.*

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