EVALUATION OF OPTIONAL RETIREMENT PLANS

OF HIGHER EDUCATION INSTITUTIONS

FOR

THE STATE OF COLORADO

OFFICE OF THE STATE AUDITOR

Prepared by
Buck Consultants, Inc.

August 30, 2002

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This report contains the results of the evaluation of Optional Retirement Plans of higher education institutions. The evaluation was conducted pursuant to Section 2-3-103, C.R.S., which authorizes the State Auditor to conduct audits of all departments, institutions, and agencies of state government. The report presents our findings, conclusions, and recommendations, and the responses of the higher education institutions and the Colorado Commission on Higher Education.

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REPORT SUMMARY

BACKGROUND

Most Colorado state employees are members of the Colorado Public Employees Retirement Association (PERA). However, the following higher education institutions offer defined contribution (DC) retirement plans, referred to as Optional Retirement Plans (ORPs), to their faculty and other exempt employees as an alternative to PERA:

- The Colorado State University System, which includes Colorado State University (CSU), the University of Southern Colorado (USC), and Ft. Lewis College
- The State College System, which includes Adams State College, Mesa State College, Metropolitan State College, and Western State College
- The University of Colorado (CU)
- The University of Northern Colorado (UNC)

All faculty and exempt employees of the institutions are required to participate in the ORP, except that anyone employed at or hired by the college or university who has at least one year of PERA service can make a one-time election to remain in PERA rather than joining the ORP.

The ORPs are defined contribution (DC) type retirement plans. In a DC plan, the investment risks and rewards lie with the participants; the employee directs where the money in his or her account is invested from a menu of investment funds. Both the employee and the employer make a contribution as a fixed percentage of an employee's salary to the account. Employee contributions are 8.0% of salary for all institutions except CU. At CU, both the University and employees contribute 6.2% of salary to Social Security, and CU employees contribute 5.0% to the ORP. Employer contributions range from 9.0% at CSU, where the institution contributes an additional 2.6% of salary to fund disability and medical benefits, to 11.5% at UNC.

Under contract with the institutions, fund vendors or sponsors provide investment options and some administrative services. As of December 31, 2001, there were 9,951 active participants in the ORP's and about 8,700 inactive members (retired and terminated employees who kept their money in the plan). The total of account balances was $357,843,504 for active employees and $331,324,178 for inactive employees, and the average fund balance per active participant for all the ORPs combined was $35,961.

PURPOSE AND SCOPE

Under contract to the State Auditor, Buck Consultants performed an evaluation of the Optional Retirement Plans (ORPs) administered by Colorado's higher education institutions. The evaluation included assessing the management and fiduciary oversight of the plans, analyzing the adequacy of the retirement benefits the plans provide, and identifying best practices with respect to management of such retirement plans.

FINDINGS

The ORPs are in general compliance with current law, plan documents are up-to-date, and the contribution levels are reasonable to achieve an adequate benefit for a career employee.

However, there appears to be little involvement on the part of the institutions to structure an investment program that gives employees the best chance to achieve an adequate retirement benefit level. The ORPs mandate both employee and employer contributions and are intended to serve as the primary retirement vehicle for their participating members. As such, we believe the plans should be actively managed under clearly-defined fiduciary standards. We identified a number of concerns with respect to the higher education institutions' fiduciary oversight and management of the ORPs, as described below.

Statutory Guidance: The only statutory direction provided with respect to the duties of the college and university governing bodies that establish ORPs is in Section 24-54.5-104, C.R.S., which states that the governing bodies are responsible for administering the plans and designating fund sponsors. However, guidance exists elsewhere on the fiduciary responsibilities that administrators of mandatory retirement plans should undertake. For example, Title I of the Employee Retirement Income Security Act of 1974 (ERISA) establishes stringent rules, such as due diligence standards, for non-governmental fiduciaries of retirement plans. In addition, Colorado's Uniform Prudent Investor Act (Section 15-1.1-101, et seq., C.R.S.) establishes specific requirements for individuals who manage trust assets and Section 24-52-101 et seq., C.R.S., establishes the State's Deferred Compensation Committee, which must carry out its duties in a manner consistent with ERISA standards. Furthermore, common law trust standards, which include, among others, the prudent person rule, do apply to plans such as Colorado's ORPs. The limited statutory direction could lead to weaknesses in the monitoring, oversight, and other activities typically undertaken by fiduciaries of retirement programs. Lack of strict monitoring and oversight by the fiduciaries could result in under-performing investment choices being offered, excessive expense ratios being imposed, or participating employees not being given the education and other tools necessary to construct appropriate investment portfolios. We believe the governing boards of the colleges and universities should seek direction on their fiduciary responsibilities relative to the plans. The first step in this effort should be to seek legal clarification regarding the duties the institutions should undertake as administrators of the plans. Based on the legal interpretation provided, the institutions should seek legislative changes to specify their responsibilities in statutes.

Governance: None of the institutions has a formal retirement board or committee acting in a fiduciary capacity. As a result, the institutions may be more vulnerable to lawsuits or other claims of breach of fiduciary duty than if they had retirement boards actively managing the ORPs. Most DC plans of governmental employers operate under the governance of a committee that sets administrative policies and selects investment funds. The statutory changes recommended above should incorporate the establishment of one or more boards to manage the ORPs. Options include each institution establishing an oversight committee or combining the ORPs under a single retirement board or committee. A combined structure would pool the assets of the ORPs to improve the buying power, transfer the fiduciary responsibility away from the college or university boards, reduce fees as a percent of assets, and improve the investment fund offerings.

Oversight of Fund Options: The higher education institutions do not have formal investment policies and do not routinely review investment fund options. There are wide variations in the number and type of fund options available to ORP members, with fund sponsors offering from

10 to 136 different funds. There are strengths and weaknesses in the fund offerings, with gaps and redundancies in the slate of funds from each fund sponsor. Reviewing fund performance and taking actions based on that review will help plan members achieve their retirement goals by ensuring they are offered funds that perform well relative to their benchmarks. Allowing employees to self-direct their investments does not absolve the fiduciary of the responsibility to carefully and prudently select investment funds. Therefore, we recommend that the colleges and universities monitor and direct the number and types of fund options offered by sponsors.

Monitoring Fund Performance: The institutions do not assess the performance of individual funds or of the fund sponsors in part because they do not require routine reporting by the sponsors. The institutions should have information on the funds offered to participants, including asset allocations and fund and account balances, to evaluate the funds and monitor fund fees. We found that although the annual expense ratios for three of the fund sponsors are lower than average, the expense ratio for one fund sponsor, used by all institutions except CU, is significantly higher than average. These high expenses negatively impact the program's overall investment performance. Our analysis also found all the institutions use fund sponsors that offer some under-performing funds. Common law requires the plan administrators to exercise care, skill, prudence, and diligence when making decisions regarding plan management. The colleges and universities should regularly monitor fund performance and take appropriate action when funds under-perform. In addition, to obtain lower fees, the institutions should consider combining their plans into fewer ORPs that serve multiple institutions. This would create a large asset pool, allowing institutional funds with lower fee schedules to be used, and would reduce the expenses associated with oversight and administration.

Participant Education: The higher education institutions rely primarily on the fund sponsors to provide education to participants. Education should assist members to make choices regarding which fund sponsors to use, which funds to select, and how to allocate their assets among various fund categories. Educational efforts are essential to ensure plan participants understand the ramifications of their investment choices and choose an investment approach that is consistent with their tolerance for risk yet also ensures benefit adequacy at retirement. Retirement benefit adequacy is measured by the ability of the retirement benefit to keep a retired employee at the same standard of living that the employee enjoyed just prior to retirement. Our analysis generally indicates that the ORPs will provide an adequate benefit for average or aggressive investors, but not for a conservative investor. However, even among average and aggressive investors, some will fall short of the adequacy level due to poor investment decisions or shorter working careers. The higher education institutions can maximize the chance ORP members have to achieve benefit adequacy by overseeing and directing the number and types of fund options available, taking steps to minimize expenses, and providing education to employees. The institutions should expand their educational efforts to supplement those of the fund sponsors.

Our recommendations and the responses of the higher education institutions and the Colorado Commission on Higher Education can be found in the Recommendation Locator.

RECOMMENDATION LOCATOR

Rec. No.	Page No.	Recommendation Summary	Agency Addressed	Agency Response	Implementation Date
1	16	Seek a legal opinion regarding the fiduciary responsibilities relative to the ORPs. On the basis of the legal opinion, consider pursuing legislative changes to specifically define in statute the fiduciary duty responsibilities of the higher education institution governing bodies.	Colo. Commission on Higher Education	Agree	2004 Leg. Session
			Colorado State University System	Agree	December 31, 2002
			Ft. Lewis College	Agree	January 2003
			State College System	Agree	2004 Leg. Session
			University of Colorado	Agree	2003 Leg. Session
			University of Northern Colorado	Agree	December 31, 2003
2	19	In pursuing statutory changes for the ORPs, consider options for establishing boards to oversee the plans. Options include having each institution establish a retirement board; combining all ORPs, except CU, under a single retirement board; or combining all the ORPS, including CU, under a single retirement board.	Colo. Commission on Higher Education	Agree	December 2003
			Colorado State University System	Partially Agree	December 31, 2003
			Ft. Lewis College	Agree	July 1, 2003
			State College System	Agree	July 1, 2003
			University of Colorado	Agree	December 31, 2003
			University of Northern Colorado	Partially Agree	December 31, 2003
3	26	Monitor and direct the number and types of fund options offered by sponsors.	Colo. Commission on Higher Education	Agree	Fiscal Year 2004
			Colorado State University System	Partially Agree	December 31, 2003
			Ft. Lewis College	Partially Agree	July 1, 2003
			State College System	Agree	Fiscal Year 2004
			University of Colorado	Agree	December 31, 2003
			University of Northern Colorado	Agree	December 31, 2003
4	31	Regularly monitor fund performance against benchmarks and take appropriate action when funds under-perform. Monitor the overall performance of fund sponsors by requiring consolidated fund reporting to use in tracking the cash flow and assets of each plan on an ongoing basis.	Colo. Commission on Higher Education	Agree	Fiscal Year 2004
			Colorado State University System	Partially Agree	December 31, 2003
			Ft. Lewis College	Partially Agree	July 1, 2003
			State College System	Agree	Fiscal Year 2004
			University of Colorado	Agree	December 31, 2003
			University of Northern Colorado	Partially Agree	December 31, 2003
5	36	Take steps to obtain more favorable contractual terms and conditions from fund sponsors. Regularly monitor and manage investment-related fees and consider collectively offering a smaller number of ORPs to permit the use of unbundled arrangements leading to lower fees.	Colo. Commission on Higher Education	Agree	Fiscal Year 2004
			Colorado State University System	Partially Agree	December 31, 2002
			Ft. Lewis College	Partially Agree	July 1, 2003
			State College System	Partially Agree	Fiscal Year 2004
			University of Colorado	Agree	December 31, 2003
			University of Northern Colorado	Partially Agree	December 31, 2003

RECOMMENDATION LOCATOR

Rec. No.	Page No.	Recommendation Summary	Agency Addressed	Agency Response	Implementation Date
6	45	Expand education provided to employees participating in the ORPs. Include education presented by independent investment experts to supplement any educational efforts of the fund sponsors.	Colo. Commission on Higher Education	Agree	July 2003
			Colorado State University System	Agree	Ongoing
			Ft. Lewis College	Agree	July 1, 2003
			State College System	Partially Agree	Fiscal Year 2004
			University of Colorado	Agree	November 2002
			University of Northern Colorado	Partially Agree	December 31, 2003

I. PROJECT PURPOSE AND SCOPE

Five of Colorado's higher education institutions and the State College System have adopted defined contribution type retirement plans for faculty and other employees who are exempt from the State personnel system. These plans are referred to as Optional Retirement Plans, or ORPs, since they offer an alternative approach to the Colorado Public Employees Retirement Association (PERA) for providing retirement benefits to employees. Under contract to the State Auditor, Buck Consultants performed an evaluation of the ORPs to:

1. Evaluate the extent to which the higher education institutions directly administer or manage the plans, benefits offered by the plans, the employee and employer contribution rates for the plans, the withdrawal features of the plans, and the roles of any advisory committees or boards.

2. Assess the institutions' fiduciary and general oversight of the plans and the fund sponsors that directly manage the plans. This included 1) determining whether the institutions have established written contracts with the fund sponsors that contain performance measures and expectations; 2) reviewing the processes used to select fund sponsors; and 3) examining the extent to which the institutions monitor plan performance and participation.

3. Analyze the cost to the higher education institutions of administering the plans and of the adequacy of the retirement benefits the plans provide.

4. Compare the returns on investment and asset allocations of the plans with other similar defined contribution (DC) retirement plans.

5. Review the processes used to educate plan participants and potential participants regarding the retirement plans, including a consideration of whether all education and marketing of the plans is conducted by the fund sponsors.

6. Identify best practices with respect to management of DC retirement plans.

7. Make recommendations for improvement in the administration and management of the Optional Retirement Plans by the higher education institutions.

This report presents the results of our work.

II. DESCRIPTION AND ADMINISTRATION OF THE OPTIONAL RETIREMENT PLANS

HISTORY OF THE ORPS

Most Colorado state employees are members of the Colorado Public Employees Retirement Association (PERA). Although the PERA benefit has evolved over time to include defined contribution (DC) features, the benefit for PERA members is primarily a defined benefit pension. However, some employees of higher education institutions participate in alternative retirement plans. For example, the University of Colorado (CU) has historically covered its faculty and administration staff with a defined contribution plan other than through PERA. The CU plan was established in 1924. In addition, in 1992, state statutes were changed to allow other higher education institutions to establish optional plans (referred to as ORPs – Optional Retirement Plans). Section 24-54.5-101, et seq., C.R.S., authorizes higher education institution governing boards in Colorado to offer defined contribution retirement plans to their faculty and other employees who are exempt from the State personnel system as an alternative to participation in PERA. By the end of 1994, higher education institutions that had adopted ORPs included:

- The Colorado State University System, which includes Colorado State University (CSU), the University of Southern Colorado (USC), and Ft. Lewis College
- The State College System, which includes Adams State College, Mesa State College, Metropolitan State College, and Western State College
- The University of Colorado (CU)
- The University of Northern Colorado (UNC)

Beginning in Fiscal Year 2003, Metropolitan State College is no longer part of the State College System and Fort Lewis College is no longer part of the CSU System.

The ORPs are essentially mandatory plans. All faculty and exempt employees of the institutions are required to participate in the ORP, with two exceptions:

1. Any eligible employee who was a member of PERA on the effective date of the ORP and had at least one year of PERA service credit could elect to remain in PERA or to participate in the ORP.

2. Any eligible employee hired after the effective date of the ORP who has at least one year of PERA service credit can elect to participate in the ORP or to retain their PERA membership. Newly hired employees with less than one year of PERA service credit are required to join the ORP.

Employees choosing the ORP can leave their contributions in PERA and retain a PERA benefit based on their prior participation, or elect to transfer their PERA contributions to the ORP, thereby waiving all rights and benefits provided by PERA.

TYPE OF RETIREMENT PLAN

The Optional Retirement Plans (ORPs) are defined contribution type retirement plans. As the name implies, defined contribution (DC) plans define the level of contribution made to the plan, not the retirement income level. The benefit paid by a DC plan is contingent on the amount of

contributions made and the investment income accumulated in an individual employee's account over the course of the employee's career. Both the employee and the employer make a contribution as a fixed percentage of an employee's salary to the account. In a DC plan, the investment risks and rewards lie with the participants. Unlike a traditional pension plan, since there is no guarantee of a defined benefit in a DC plan, there is no actuarial necessity for the contribution to vary as investment returns change.

The employee directs where the money in his or her account is invested from a menu of investment funds. At retirement, the employee receives the value of the account that has accumulated. The value of the account is not known until retirement and the amount is not guaranteed. The distribution at retirement can be in the form of a lump sum, installment payments over a fixed number of years, a monthly annuity payable for life, or a direct rollover to an IRA.

The ORPs are tax-qualified "money purchase" retirement plans that meet the requirements of Section 401(a) of the Internal Revenue Code. Each of the ORPs has adopted a legal plan document that specifies the participation requirements, contribution levels, administrative responsibilities, and benefit eligibility. They have all requested and received favorable determination letters from the IRS verifying their tax-qualified status. This status is important because it allows employee contributions to be made on a pre-tax basis, and assures the investment income and employer contributions are not taxable to the employee until distributed.

MANAGEMENT AND ADMINISTRATION OF THE ORPS

The responsibility for managing and administering the ORPs rests with the employer. More specifically, the governing board of the college or university or persons designated by the governing board have responsibility and authority to administer the plan, interpret plan provisions, hire professionals and service providers, and amend, replace, or terminate the plan. These responsibilities are defined for each ORP by the plan document, a legal document that defines the rules of plan operation. Much of the day to day administration is delegated to staff employees, typically in finance, human resources, or employee benefit departments.

Fund vendors or sponsors are selected to provide investment options, recordkeeping services, investment education, and trustee or custodial services to pay distributions and hold funds. Staff of the institutions help communicate the plan to eligible employees, facilitate employee elections, and coordinate contributions and the payroll information flow to the fund sponsors. Eligible employees can select a fund sponsor from a short list selected by the employer. Current fund sponsors selected by the higher education institutions are shown in the following table:

II. DESCRIPTION AND ADMINISTRATION OF THE OPTIONAL RETIREMENT PLANS

Higher Education Institution	FUND SPONSOR				
	TIAA-CREF	VALIC	Fidelity	Vanguard	Travelers/ CitiStreet
CU	X		X	X	
CSU	X	X	X		
UNC	X	X			X
State Colleges	X	X	X		
USC	X	X			
Ft. Lewis College	X	X			
Source: Information provided by the higher education institutions.					

TIAA-CREF is a non-profit organization, VALIC and Travelers/CitiStreet are insurance companies, and Fidelity and Vanguard are mutual fund companies. The fund sponsors provide "bundled" services, which means the investment management, custody, and administrative services are combined. Fees for administrative services are typically charged as a percentage of the assets along with the investment management fees. In addition to asset-based administrative fees, some fund sponsors charge annual fees to each participant account for recordkeeping and custody services. Each higher education institution uses either two or three bundled providers, constituting multiple-bundled arrangements.

MEMBER INFORMATION

The following three tables provide information for members actively participating in the ORPs on December 31, 2001. In addition to active employees, each ORP contains accounts for retired and terminated employees who have kept their money in the plan. As of December 31, 2001, there were 8,732 such inactive members with balances of $331,324,178, making the total of active and inactive members 18,683 and the total of account balances $689,167,682. Further detail on all active and non-active members is included in Appendix A.

The information provided by sponsors showed a total of 9,951 eligible employees actively participating in the six ORP's on December 31, 2001. The participation by each higher education institution and fund sponsor is shown in the following table:

II. DESCRIPTION AND ADMINISTRATION OF THE OPTIONAL RETIREMENT PLANS

	NUMBER OF EMPLOYEES ACTIVELY PARTICIPATING PER FUND SPONSOR					
Institution	**TIAA-CREF**	**VALIC**	**Fidelity**	**Vanguard**	**Trav./CitiSt.**	**Total**
CU	610	-	1,995	2,074	-	4,679
CSU	1,118	601	1,398	-	-	3,117
Ft. Lewis	232	29	-	-	-	261
State Colleges	483	184	313	-	-	980
UNC	316	221	-	-	23*	560
USC	204	150	-	-	-	354
Total	2,963	1,185	3,706	2,074	23	9,951

Source: Information provided by fund sponsors.

* Estimated number of participants provided by the University of Northern Colorado. Travelers/CitiStreet did not provide information for the evaluation. See Recommendation No. 4 for related information.

The total of employee and employer account balances for these active employees was $357,843,504. As expected, CU had the most employees participating in the ORP and also had the largest total balance. The following table summarizes the total account balances for each higher education institution by fund sponsor:

	TOTAL BALANCES FOR ACTIVE EMPLOYEES PER FUND SPONSOR AS OF DECEMBER 31, 2001					
Institution	**TIAA-CREF**	**VALIC**	**Fidelity**	**Vanguard**	**Trav./CitiSt.**	**Total**
CU	$ 55,100,012	$ -	$ 46,099,361	$ 49,432,978	$ -	$150,632,351
CSU	46,149,290	29,235,509	55,421,224	-	-	130,806,023
Ft. Lewis	4,363,324	791,909	-	-	-	5,155,233
State Colleges	16,410,971	8,852,870	12,496,674	-	-	37,760,515
UNC	15,453,184	8,528,595	-	-	$500,000*	24,481,779
USC	4,357,269	4,650,334	-	-	-	9,007,603
Total	$141,834,050	$ 52,059,217	$114,017,259	$ 49,432,978	$500,000	$357,843,504

Source: Information provided by fund sponsors.

* Estimated account balance provided by the University of Northern Colorado. Travelers/CitiStreet did not provide information for the evaluation. See Recommendation No. 4 for related information.

The average fund balance per participant for all the ORPs combined is $35,961. The fund balances vary from employee to employee based on length of ORP participation, salary level, contribution rate, investment performance, and the extent rollovers into the plan occurred due to previous employment. The average account balances for each higher education institution by fund sponsor follows:

	AVERAGE BALANCE FOR ACTIVE EMPLOYEES BY FUND SPONSOR AS OF DECEMBER 31, 2001					
Institution	TIAA-CREF	VALIC	Fidelity	Vanguard	Trav./CitiSt.	Total
CU	$ 90,328	$ -	$ 23,107	$ 23,835	$ -	$ 32,193
CSU	41,278	48,645	39,643	-	-	41,965
Ft. Lewis	18,807	27,307	-	-	-	19,752
State Colleges	33,977	48,113	39,925	-	-	38,531
UNC	48,902	38,591	-	-	21,739	43,717
USC	21,359	31,002	-	-	-	25,445
Weighted Average	$ 47,868	$ 43,932	$ 30,766	$ 23,835	$ 21,739	$ 35,961

Source: Buck Consultants analysis of information provided by fund sponsors and higher education institutions.

PLAN PROVISIONS

The plan provisions of each ORP are similar. A summary of the major provisions are as follows:

- *Employee contributions* – Eligible employees contribute 8.0% of salary with the exception of University of Colorado employees who contribute 5.0% of salary. University of Colorado employees also contribute 6.2% of salary into Social Security up to the maximum wage base ($84,900 annually in 2002).

- *Employer contributions* – The employers contribute the following percentages of salary to the ORPs:

Higher Education Institutions	Contribution Rate
CU	10.0%*
CSU	9.0%**
UNC	11.5%
State Colleges	11.4%
USC	11.1%
Ft. Lewis College	11.4%

Source: Information provided by fund sponsors and higher education institutions.

* CU also pays 6.2% of salary up to the maximum wage base ($84,900 in 2002) into Social Security.

** CSU also pays 2.6% of salary to fund disability and medical benefits.

- *Normal retirement age* – Age 55, except for the University of Northern Colorado where the normal retirement age is 65. The normal retirement age defines the eligibility for receiving retirement benefits.

- *Vesting* – 100% immediately on both employee and employer account balances for all institutions.

- *Forms of distribution* – Lump sums, direct rollovers, periodic payments over a fixed period, and lifetime annuity options are available for all institutions' ORPs.

- *In-service withdrawals* – No distributions while actively employed are allowed by any of the ORPs.

- *Rollovers/Transfers* – All plans allow rollovers and transfers into or out of the plan to other eligible retirement plans.

- *Loans* – Permitted by all plans except those of the University of Colorado and the State College System.

- *Investment elections* – For all plans, eligible employees can direct their contributions to only one fund sponsor at a time. Employees can direct their money into any of the investment funds made available by their selected fund sponsor.

A summary of plan provisions can be found in Appendix B.

III. STATUTORY GUIDANCE

OVERVIEW

Defined contribution plans such as the ORPs offer employees choice and portability. Plan participants choose how to invest their funds and have the ability to take their account balances, including employee and employer contributions, as well as accumulated earnings, when they terminate employment. Shifting responsibility for retirement plan investments to employees, along with the risks and rewards of such investments, through the use of defined contribution ORPs, is significant. This shift has human resources as well as legal, regulatory, and risk management implications. For example, on the human resources side of the equation, colleges and universities that adopt ORPs may ultimately find it difficult to attract and retain the most qualified faculty and administration if overall investment return is substandard over time. Substandard returns may occur if the funds available are inadequate or inferior, the expense ratios are larger than necessary, or employees are not provided the investor education necessary to construct investment portfolios that achieve competitive returns over time.

Based on our examination, we find the ORPs are in general compliance with current law, plan documents are up-to-date, the plans are determined qualified by the IRS, and the contribution levels are reasonable to achieve an adequate benefit for a career employee. However, there appears to be little involvement on the part of the institutions to structure an investment program that gives employees the best chance to achieve an adequate retirement benefit level. We found that some plans offer under-performing funds with high retail fees. Better funds should be offered in some cases, institutional funds with lower expenses should be used and/or fees should be negotiated, and more independent education regarding the plans should be offered by the colleges and universities. Our recommendations throughout this report are intended to increase the effectiveness of the ORPs by increasing fiduciary oversight to ensure employees are offered the best chance of to achieve an adequate retirement benefit.

STATUTORY GUIDANCE FOR FIDUCIARY AND OVERSIGHT STANDARDS IS LACKING

Colorado statutes are limited with respect to assigning specific fiduciary duties to the college and university governing bodies that establish ORPs. Section 24-54.5-104, C.R.S., states that the governing bodies are responsible for setting the terms and conditions of the plans and that they shall:

- Provide for the administration of such optional retirement plans.
- Designate the fund sponsors from which ORP contracts will be purchased.
- Consider the nature and extent of the rights and benefits to be provided under ORP contracts and the relation of such rights and benefits to the amount of contributions to be made.

These are the only specific provisions in the ORP statutes regarding the management and administration of the plans. However, guidance exists elsewhere on the fiduciary responsibilities that administrators of mandatory retirement plans should undertake. For example, Title I of the Employee Retirement Income Security Act of 1974 (ERISA), other Colorado statutes, and

common law standards, all provide direction on the duties of plan fiduciaries as described below. Because the ORPs are mandatory and serve as the primary retirement vehicles for their members, these legal standards serve as guidelines for the higher education institutions in overseeing and managing their ORPs.

ERISA

ERISA establishes stringent rules for fiduciaries who have responsibility for retirement plans. The Act requires that fiduciaries perform their functions "solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits to participants …." In addition, fiduciaries must discharge their duties with respect to the plan "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." A detailed description of fiduciary duty rules under Federal Law as required by ERISA can be found in Appendix C.

The governing boards and the persons who manage and control the administration of the ORPs are not subject to ERISA, which is inapplicable to governmental plans. However, ERISA provides a reasonable standard for the institutions to follow and many of the general concepts embodied in ERISA, particularly the prudent expert (upgraded from prudent person standard under common law) and due diligence standards, have been incorporated into state statutes applying to other retirement systems.

State Statutes

There are several Colorado statutes, described below, which do not specifically apply to the ORPs but serve as examples of the fiduciary responsibilities assigned to organizations that manage investment and retirement plans.

The Uniform Prudent Investor Act: Section 15-1.1-101, et seq., C.R.S., establishes requirements for individuals who manage trust assets and owe a fiduciary duty to the beneficiaries of the trust. Among other requirements, the Act states that a trustee shall invest and manage trust assets as a prudent investor would and may only incur costs that are appropriate and reasonable. The Act also allows the delegation of functions if reasonable care, skill, and caution are exercised in selecting agents, establishing the scope and terms of delegation, and periodically reviewing the agent's actions to monitor performance and compliance with delegation terms. Although the ORP statutes make no specific reference to the Uniform Prudent Investor Act, it is generally applicable to any trust situation. As such, it should be considered a model for determining the fiduciary duty of the ORPs.

County, Municipal, and Special District Officers' and Employees' Retirement Systems: Section 24-54-101, et seq., C.R.S., establishes requirements for county, municipal, and special district retirement systems in Colorado. These statutes contain some provisions similar to ERISA rules. For example, Section 24-54-112, C.R.S., relieves fiduciaries of responsibility for self-directed investments by participants. Section 404(c) of ERISA contains a special rule which also relieves fiduciaries of ERISA-covered plans from responsibility for participant-directed

investment decisions, but only if stringent rules are satisfied. These rules essentially require that participants be offered an opportunity to choose from a broad range of investment alternatives and be given sufficient information to make informed decisions with regard to the investment alternatives available. To satisfy the ERISA 404(c) rules, most private-sector plan sponsors provide comprehensive investor education and extensive disclosures relating to investment alternatives, including investment characteristics and expense ratios for each available investment alternative. Because ERISA is not applicable to ORPs, the safe harbor protection provided by Section 404(c) is unavailable to the governing bodies that establish ORPs. Furthermore, Section 24-54-101, et seq., C.R.S., does not apply to the ORPs.

The State Deferred Compensation Plan: Section 24-52-101 et seq., C.R.S., establishes the State's Deferred Compensation Committee, which is responsible for managing the State's voluntary deferred compensation plan. Statutes require the committee to carry out its duties in a manner consistent with ERISA standards, stating that the committee shall:

- Exercise its functions solely in the interest of plan participants and their beneficiaries;
- Act with care, skill, and diligence; and,
- Avoid engaging in any activity which might result in a conflict of interest with the administrative functions of the plan.

The deferred compensation plan is a defined contribution plan in which state employees may voluntarily invest funds and direct their own investments. Because the ORPs are mandatory plans, it is reasonable to expect that they would be required to follow fiduciary responsibility standards that are at least as stringent as those of the voluntary State deferred compensation plan.

PERA: The Colorado Legislature, like many States, essentially incorporated the core fiduciary standards of ERISA into the statutes governing the conduct of the Board of Trustees of PERA. According to Section 24-51-201, et seq., C.R.S., PERA trustees are fiduciaries and are personally liable for their breach of fiduciary duties, which include:

- Acting solely in the interest of PERA members and benefit recipients for the exclusive purpose of providing benefits and defraying the reasonable expenses of PERA.
- Acting with the care, skill, prudence, and diligence in light of the circumstances then prevailing that a prudent expert would use in the conduct of a similar enterprise.
- Diversifying the investments of PERA so as to minimize the risk of large losses unless it is clearly prudent not to do so.
- Avoiding activities which might result in a conflict of interest.

COMMON LAW STANDARDS

Although ERISA does not apply to the ORPs, the fiduciary standards of the Act follow much of the common law trust standards that applied even before ERISA was enacted. These common law standards still apply to plans exempt from ERISA like Colorado's ORPs. These common law trust standards include, among others, the prudent person rule and the care and due diligence standards for administering the plan.

III. STATUTORY GUIDANCE

The ORPs mandate both employee and employer contributions and are intended to serve as the primary retirement vehicle for their participating members. As such, the plans should be managed under clearly-defined fiduciary standards. The sparse statutory direction given to college and university governing bodies that establish ORPs and persons who manage and control the administration of ORPs may have two unintended adverse consequences.

First, the traditional monitoring, oversight, and other activities typically undertaken by fiduciaries of public and private sector retirement programs may not take place to the same extent or with the same care because there is no explicit statutory mandate to undertake such activities. For example, as discussed in more detail later in this report, the institutions do not have formal investment policies or conduct rigorous annual reviews of investment fund choices and investment results against benchmarks. In addition, the contracts between the institutions and the fund sponsors are similar to contracts used by private sector retirement plans. The contracts used by the private sector do not assign fiduciary duties to the fund sponsors because under ERISA, those duties are the responsibility of the plan administrator. Many of the ORP contracts treat the institutions as retaining the responsibilities that named fiduciaries under ERISA would retain, such as the responsibility to exercise due diligence in administering the plan, although the institutions are not subject to ERISA. Based on the information we received for this study, we believe the institutions should establish procedures to ensure that fiduciary responsibilities are fulfilled.

Lack of strict monitoring and oversight by the fiduciaries could result in underperforming investment choices being offered under ORPs, excessive expense ratios being imposed, or participating employees not being given the investor education and other tools necessary to construct appropriate investment portfolios. These concerns are discussed more fully later in the report. The latter concern is particularly important because ORPs shift the investment responsibility to individual employees. Without careful selection and monitoring of investment choices and effective investor education, colleges and universities may not realize the full potential of ORPs to attract and retain the most qualified faculty and administration.

Second, to the extent investment returns suffer for any reason or other problems arise in the administration of ORPs (such as an operational defect affecting qualification of an ORP under IRC Section 401(a)), college and university governing boards and others responsible for the management and control of the administration of ORPs may find themselves facing legal challenges in an uncertain legal environment. This could result in unanticipated legal defense and indemnity costs and/or substantial payments to the Internal Revenue Service.

Although the common law trust standards discussed above do apply to the ORPs, and good public policy dictates that the institutions carry out these types of responsibilities, these standards are not clearly reflected in the statutes pertaining to the ORPs. The governing boards of the colleges and universities should seek direction on their fiduciary responsibilities relative to the plans. The first step in this effort should be to seek legal clarification regarding the duties the institutions should undertake as administrators of the plans. Based on the legal interpretation provided, the institutions should seek legislative changes to specify in the ORP statutes the oversight responsibilities of the institutions as a matter of sound retirement plan policy. Both the

legal clarification and any subsequent statutory changes should address the recommendations contained throughout the remainder of the report. These recommendations address:

- The establishment of ORP boards or committees to set policies for the plans.
- The duties of the institutions to monitor and direct the number and types of fund options offered, to monitor fund performance against benchmarks and take action when funds under-perform, to monitor and negotiate for lower fees, and to provide independent education to plan participants.

RECOMMENDATION 1

The colleges and universities should seek a legal opinion regarding the fiduciary responsibilities of their governing boards with respect to the ORPs. This should include obtaining clarification on their responsibilities for:

a. Monitoring and directing the number and types of fund options offered by sponsors.
b. Monitoring fund performance against benchmarks and taking action when funds under-perform.
c. Monitoring and negotiating for lower fees.
d. Providing independent education to plan participants.

On the basis of the legal opinion obtained, the colleges and universities should consider working with the Legislature to specifically define in the statutes the fiduciary duty and oversight responsibilities of their governing bodies as well as fund sponsors that manage and control the investments and administration of ORPs. This should include outlining the specific duties of the governing boards with respect to items a through d, above, and ensuring the duties are consistent with the provisions of the Uniform Prudent Investors Act.

COLORADO COMMISSION ON HIGHER EDUCATION RESPONSE:
Agree. A single legal opinion on these issues would serve to clarify ambiguities and responsibilities. This legal opinion should also include recommendations for statutory changes if warranted. If statutory changes are indicated, they should be addressed in the 2004 legislative session.

COLORADO STATE UNIVERSITY SYSTEM RESPONSE:
Agree. The Colorado State University System believes that a clear understanding of any legal fiduciary obligations is critical to developing effective and efficient means of managing those responsibilities. To that end, we will work with the other institutions offering ORPs in submitting a request to the State's Attorney General for clarification of this issue. It is anticipated that the request will be filed with the Attorney General no later than December 31, 2002. The System will participate in any effort by the Legislature to define such fiduciary responsibility.

FT. LEWIS COLLEGE RESPONSE:
Agree. Fort Lewis College agrees that a legal opinion must be obtained to clarify the fiduciary responsibilities of the administrators of the Higher Education Optional Retirement Plans. At the time Fort Lewis College instituted the ORP it was believed that the fiduciary responsibility for monitoring fund performance, and the number and types of funds, were the responsibility of the plan sponsors, such as TIAA-CREF and VALIC. Our responses to several of the following recommendations are dependent on the legal opinion obtained. Implementation date: January 2003.

STATE COLLEGE SYSTEM RESPONSE:
Agree. The State Colleges in Colorado will work with their retirement plan attorney and their Attorney General legal representative to obtain a legal opinion regarding fiduciary responsibilities during this fiscal year. If the legal opinion warrants, the Office of State Colleges will consider working with the Legislature to redefine the statutes governing the ORPs during the 2004 legislative session. The Board of Trustees for the State Colleges in Colorado, the plan administrator, the contracted fund sponsors, and the other administrative employees within the Office of State Colleges and the four affiliated colleges, are aware of their fiduciary responsibilities. The board members and state employees listed above rely on advice from their attorney, who specializes in 401a and 403b compliance. In addition, other retirement plan specialists are contracted with when necessary. The three fund sponsors also maintain (or have access to) tax attorneys that remain current on all retirement compliance issues.

UNIVERSITY OF COLORADO RESPONSE:
Agree. The University of Colorado agrees that the fiduciary duty and oversight responsibilities for its ORP governing bodies and fund sponsors should be more clearly defined. The university will work with the other institutions to seek legal clarification from the State of Colorado Attorney General on those duties and responsibilities. Based on that result, we are committed to researching what further fiduciary duty and oversight responsibilities are appropriate, and working with the Legislature on needed legislative changes. The request for legal opinion and further research will commence immediately. We will target working with the Legislature to implement legislative changes in the 2003 session, contingent on the timing of the receipt of the legal opinion and completion of research.

UNIVERSITY OF NORTHERN COLORADO RESPONSE:
Agree. Collaborating efforts of governing boards and sponsoring organizations to define the fiduciary duty and oversight responsibilities of the college and university governing bodies and fund sponsors that manage and control the investments and administration of ORPs will be beneficial. Therefore, we will work with other institutions and the State's Attorney General for clarification of this issue. Implementation following clarification of this issue no later than December 31, 2003.

IV. GOVERNANCE

Most DC plans of governmental employers operate under the governance of a board or committee that sets administrative policies and selects investment funds. The boards carry out their duties in a manner consistent with the fiduciary responsibilities established under ERISA or other legal standards, as discussed in the previous section. In many cases these boards administer both defined benefit and defined contribution plans. For example, the PERA Board administers a 401(k) plan and the Fire and Police Pension Association Board administers a state-wide money purchase plan. Furthermore, two sizable defined contribution plans in Colorado, the State's 457 Deferred Compensation Plan and the Colorado County Officials and Employees Retirement Association, administer defined contribution plans, the latter for a majority of counties in Colorado. Both of these plans are administered by a single board or committee established in statute. Having a board or committee responsible for establishing policies and making decisions regarding the plans is important because the plans are mandatory for certain employees and are the primary retirement vehicle for those employees.

THE HIGHER EDUCATION INSTITUTIONS DO NOT HAVE FORMAL RETIREMENT BOARDS OR COMMITTEES

We found the higher education institutions use a variety of methods to direct and oversee their ORPs. They are as follows:

- CU – The System Administration department is defined as the plan administrator. Administrative duties of the plan are coordinated by the Director of Benefits.

- CSU – The employer, Colorado State University, is defined as the plan administrator. Administrative duties of the plan are delegated to the Human Resource Services Department.

- State Colleges – The Trustees designate the person or persons to act as plan administrator. The plan administrator designated by the Trustees is the Vice President for Administration and Finance. Local representatives of the plan administration handle administrative duties at each state college.

- UNC – The employer designates the person or persons to act as the plan administrator. The Senior Vice President, Finance and Administration, has been designated by the employer to administer the plan.

- USC – The employer, University of Southern Colorado, is defined as the plan administrator. Administrative duties of the plan are coordinated by the Director of Human Relations.

- Ft. Lewis College – The employer, Ft. Lewis College, is the plan administrator. Administrative duties are delegated to the Human Resources office.

None of the institutions has a formal retirement board or committee acting in a fiduciary capacity. As a result, the institutions may be more vulnerable to lawsuits or other claims of breach of fiduciary duty than if they had retirement boards actively managing the ORPs. To improve governance and general oversight of the ORPs, the statutory changes recommended

above should incorporate the establishment of one or more boards to manage the ORPs, as described in the three alternatives below.

RECOMMENDATION 2

In pursuing statutory changes for the ORPs, the colleges and universities should consider the following alternatives for establishing committees or boards to oversee the plans.

Alternative A

Each college or university with an ORP could establish an oversight committee to carry out the administrative and fiduciary duties of the Plan Administrator. The oversight committee could include representatives from the institution's governing board and its finance and human resources departments; one or more currently-contributing plan participants; and a citizen at large with investment, benefit, or legal knowledge and experience. The committee should also be supported as appropriate by investment, legal, and benefit advisors. The oversight committee should focus on implementing the remaining recommendations in the report regarding the establishment of investment policies, monitoring of the selection and performance of investment choices offered and expense ratios, and the establishment of clear and effective communications including investor education.

Alternative B

Combine the higher education ORPs, with the exception of CU, under a single retirement board or committee. The unique history of the CU ORP suggests it could be excluded from the state-level system but should implement Alternative A above. The combined committee could be composed of representatives from each higher education institution; one or more senior members of the state's finance, human resource, or legal departments; a citizen at-large with investment, benefit, or legal knowledge and experience; and one or more actively contributing plan members. This structure would pool the assets of the ORPs to improve the buying power that the smaller ORPs do not have separately, transfer the fiduciary responsibility away from the college or university boards, reduce fees as a percent of assets, and improve the investment fund offerings. This state-level Board would be responsible for:

- Carrying out the administrative and fiduciary duties of the plans.
- Contracting for record keeping and administrative services.
- Setting investment policy for all five ORPs with the same slate of investment options offered to each institution's employees.
- Selecting the investment managers and/or funds.
- Monitoring investment performance and fees.
- Coordinating employee communications and investment education.

Each college or university board would retain the right to amend or terminate its plan.

Alternative C

Establish a state-level retirement board as described under Alternative B and include the University of Colorado. This suggests that although CU has a unique history, the opportunity to join a state-level organization would create an even larger pool of assets to increase the buying power of all the ORPs, improve administrative efficiency, and allow for alternative structures that can reduce fees as a percent of assets.

COLORADO COMMISSION ON HIGHER EDUCATION RESPONSE:
Agree. The institutions in these programs should consider establishing a central; state level retirement board that could possibly gain some efficiencies by pooling the collective interests of covered retirees. The date of implementation of this recommendation should be no later than December 2003.

COLORADO STATE UNIVERSITY SYSTEM RESPONSE:
Partially agree. The best methods for managing the institutional fiduciary responsibilities cannot be determined until those responsibilities are clarified as a result of the Attorney General's analysis in recommendation #1. At the time the responsibilities are clarified, the Colorado State University System will ensure that the necessary systems and processes are in place for managing those responsibilities within the context of our participant directed investment ORP design. Should the governance and oversight responsibilities be clarified in the analysis by the Attorney General or should any related legislation be implemented in the 2003 session, we anticipate implementing any resulting changes no later than December 31, 2003.

FT. LEWIS COLLEGE RESPONSE:
Agree. Due to our unique circumstances (size and geographic location) we agree with the concept of a statewide consortium to administer a State of Colorado ORP in a manner similar to that of the State of Colorado's 457 oversight board. We understand that other governing boards may not draw the same conclusions. A reasonable alternative could be a lesser number of ORPs with some governing boards combining their existing plans. Implementation date: July 1, 2003

STATE COLLEGE SYSTEM RESPONSE:
Agree with Alternative A. Each separate college or university governing board was granted individual authority in the enabling legislation to establish an ORP. This enabling legislation allowed each governing board to establish similar, but slightly different, plan documents. Combining all plans into one, as suggested in Alternative B and C, would cause each board to compromise some of the individual components deemed appropriate to their individual plan document. The State Colleges agrees with the recommendations in Alternative A and is already in the process of establishing an advisory committee. The duties and responsibilities will be expanded to include those enumerated in Alternative A. The plan administrator and her assistant will develop a proposal for the governing board to consider at a meeting later this fall. Full implementation of an advisory committee will be July 1, 2003.

UNIVERSITY OF COLORADO RESPONSE:

Agree. The University of Colorado agrees that, based on the results of the legal opinion and research conducted in response to recommendation number 1, an appropriate oversight body

should be established, at least at the university level. We will also participate with the other higher education institutions in considering a combined committee for higher education ORPs. The formation of the appropriate oversight body is anticipated to occur no later than December 31, 2003, unless otherwise legislated pursuant to recommendation number 1.

UNIVERSITY OF NORTHERN COLORADO RESPONSE:
Partially agree. If the governing boards all agree a retirement board for higher education responsible for the plan oversight and administration would be beneficial. The board should be constructed with voluntary, uncompensated, elected or appointed individuals who are currently enrolled in ORPs. No additional compensation for this board would be needed. A retirement board may have purchasing power and be able to receive lower fees with a large group. Depending on the results of legislation implemented in the 2003 session, we anticipate implementing any resulting changes not later than December 31, 2003.

OVERSIGHT OF INVESTMENT OPTIONS

As part of our evaluation of the oversight exercised by the higher education institutions over their ORPs, Buck Consultant's Investment Consulting Practice conducted a broad analysis of each fund sponsor's fund line-up. No analysis of the funds offered by Travelers/CitiStreet, a fund sponsor for UNC, was conducted because neither Travelers/CitiStreet nor the University provided us with detailed fund information. This issue is discussed further in the next section of the report. We focused on three criteria that we deem to be objective – number and type of options, long-term investment performance, and annual expense ratios – to determine the strengths and weaknesses of each of the current fund sponsors selected by the higher education systems and institutions. It is important to note that our Investment Consulting Practice has no relationships or financial ties with any fund sponsors, which allows us to be objective in our research. We do not receive commissions from any fund sponsors.

GAPS AND REDUNDANCIES IN FUND OPTIONS INDICATE A LACK OF ACTIVE FUND MANAGEMENT

As responsible plan administrators, most organizations that offer DC retirement plans to their employees select a reasonable number of funds and options from which participants can make investment selections. For example, survey data collected by Fidelity Investments, the largest defined contribution fund sponsor, servicing 20 percent of the defined contribution marketplace, indicates that, on average, DC plan sponsors offer their employees 14 options across several fund categories. In reviewing the ORPs, we found wide variations in the number and type of options available to plan members, as shown in the following table, which indicate the institutions are not actively monitoring and managing the fund options offered to plan participants.

NUMBER AND TYPE OF FUND OPTIONS OFFERED TO ORP PARTICIPANTS							
Category	**TIAA-CREF (All ORPS)**	**VALIC (All ORPs except CU)**	**Vanguard (CU)**	**Fidelity (CU)**	**Fidelity (CSU)**	**Fidelity (State College System)**	**Benchmark Average number of options for DC Plans[1]**
Money Market	1	2	3	8	2	2	1.1
Stable Value	1	0	0	0	0	0	1.1
Fixed Income	2	9	14	15	5	5	2.9
Balanced	1	8	9	13	5	4	3.9
Domestic Equity	3	38	26	80	9	9	9.3
International Equity	1	7	8	17	3	3	3.3
Other	1	0	0	3	0	0	1.0
Total	**10**	**64**	**60**	**136**	**24**	**23**	**14**

(1) The average number of options for defined contribution plans reflects survey data gathered by Fidelity Investments. The average number of options for each asset class was calculated by averaging the number of options offered by those plans that make that asset class available to their participants. For example, for plans that make fixed income options available, the average number of fixed income options is 2.9.

We also reviewed each fund sponsor's fund slate to identify areas where gaps or redundancies may exist. Our findings revealed strengths and weaknesses for each fund sponsor, as described below.

- All the higher education institutions contract with TIAA-CREF, which offers a reasonable number of options (10) to ORP participants, and which facilitates the plan sponsor's monitoring process. The program includes a mix of money market, fixed income, balanced and equity funds as well as both index and actively-managed funds. However, there are gaps in the domestic equity slate, with no small cap or value style options.

- All the higher education institutions except CU contract with VALIC, which offers a large number of options (64) through the ORPs. The large number of options makes it difficult for the plan sponsor to monitor the funds. The programs include a mix of money market, fixed income, balanced, and equity funds as well as both index and actively-managed funds. However, there is duplication in the fund slate in the fixed income, balanced, and equity categories.

- CU uses Vanguard, which offers a mix of 60 index and actively-managed funds including money market, fixed income, balanced, and equity funds to ORP members. The program's large number of options makes it difficult for the plan sponsor to monitor the funds and there

is duplication in the fund slate in the money market, fixed income, and equity categories which may be unnecessary.

- For CU, Fidelity's 136 options offer index and actively-managed funds, including a mix of money market, fixed income, balanced and equity funds. The large number of options makes it difficult for the plan sponsor to monitor the funds, and there is duplication in the fund slate in the money market, fixed income, and equity categories which may be unnecessary.

- For CSU and the State Colleges, Fidelity offers a reasonable number of options (24 for CSU and 23 for the State Colleges) which facilitates monitoring. The program includes a mix of money market, fixed income, balanced, and equity funds, but there are gaps in the domestic equity slate in the small cap and mid cap categories. In addition, there is duplication in the equity category which may be unnecessary.

A more detailed description of the overall strengths and weaknesses of each sponsor's fund slate is shown in the following table.

SUMMARY OF STRENGTHS AND WEAKNESSES

	Strengths	Weaknesses
TIAA-CREF (All ORPs)	• Reasonable number of options (10) facilitates monitoring. • Includes a mix of money market, fixed income, balanced, and equity funds. • Includes a mix of index and actively-managed funds. • Annual expense ratios are lower than average.	• Gaps in the domestic equity slate; no small cap options or value style options.
VALIC (All ORPs except CU)	• Includes a mix of money market, fixed income, balanced, and equity funds. • Includes a mix of index and actively-managed funds.	• Large number of options (64) makes it difficult for the plan sponsor to monitor the funds. • Annual expense ratios are significantly higher than average. • Unnecessary duplication in the fund slate in the fixed income, balanced, and equity categories.
Vanguard (CU)	• Includes a mix of money market, fixed income, balanced, and equity funds. • Includes a mix of index and actively-managed funds. • Annual expense ratios are lower than average.	• Large number of options (60) makes it difficult for the plan sponsor to monitor the funds. • Unnecessary duplication in the fund slate in the money market, fixed income, and equity categories.
Fidelity (CU)	• Includes a mix of money market, fixed income, balanced, and equity funds. • Includes a mix of index and actively-managed funds. • Annual expense ratios are lower than average.	• Large number of options (136) makes it difficult for the plan sponsor to monitor the funds. • Unnecessary duplication in the fund slate in the money market, fixed income, and equity categories.
Fidelity (CSU & State Colleges)	• Reasonable number of options (24 for CSU, 23 for the State Colleges) facilitates monitoring. • Includes a mix of money market, fixed income, balanced, and equity funds. • Annual expense ratios are lower than average.	• Gaps in the domestic equity slate; no small cap options or mid cap options. • Unnecessary duplication in the fund slate in the equity category.

The potential gaps and redundancies we identified for each sponsor are shown in the following table.

GAPS AND REDUNDANCIES IN THE FUNDS OFFERED TO ORP PARTICIPANTS BY EACH SPONSOR

	Potential Gaps	Potential Redundancies
TIAA-CREF (All ORPs)	• No value-style domestic equity funds • No small cap domestic equity funds	
VALIC (All ORPs except CU)		• 9 bond funds • 8 large cap growth domestic equity funds • 6 large cap blend domestic equity funds • 4 large cap value domestic equity funds • 4 mid cap growth domestic equity funds • 4 small cap growth domestic equity funds • 2 sets of lifestyle funds
Vanguard (CU)		• 14 fixed income funds • 6 large cap value domestic equity funds • 4 large cap blend domestic equity funds • 3 money market funds
Fidelity (CU)		• 15 fixed income funds • 16 large cap blend domestic equity funds, including 2 S&P 500 index funds • 8 money market funds • 8 large cap growth domestic equity funds • 2 Europe funds • 2 Japan funds
Fidelity (CSU and State College System)	• No small or mid cap domestic equity funds • No small cap domestic equity funds	• 5 large cap blend domestic equity funds

Allowing employees to self-direct their investments does not absolve the fiduciary of the responsibility to carefully and prudently select investment funds. However, it is clear from our review that the higher education institutions are not regularly monitoring and directing the fund options offered by sponsors. Ft. Lewis College is the only institution that has employed an independent consultant to review the investment offerings of their fund sponsors, but the College has not, to date, limited the offerings of any of the sponsors.

RECOMMENDATION 3

The colleges and universities should monitor and direct the number and types of fund options offered by sponsors.

COLORADO COMMISSION ON HIGHER EDUCATION RESPONSE:
Agree. The audit shows that several of the institutions are spending more on these contributions than if this group of employees were members of the Public Employees Retirement Association (PERA) and its current employer contribution rate of 10.04%. While CCHE recognizes that these defined contribution plans do provide a measure of portability for educators to move to different institutions in the U.S., we believe it would be prudent for a broader review by the Auditor in terms of the cost of these alternative retirement programs vs. PERA and the benefit packages also compared to PERA. Implementation date: No later than the end of Fiscal Year 2004.

COLORADO STATE UNIVERSITY SYSTEM RESPONSE:
Partially agree. The alternatives available to plan sponsors in defining the numbers and types of funds and fund sponsors made available as investment choices to its ORP participants depends, in part, on the plan sponsors' fiduciary responsibilities with regard to the selection and management of funds and fund sponsors. As a result, defining these alternatives will not be possible until these responsibilities are clarified via the Attorney General's review. Depending on the outcome of that review, we would implement this change no later than December 31, 2003.

FT. LEWIS COLLEGE RESPONSE:
Partially Agree. The agreement of Fort Lewis College to recommendation 3 is dependent upon the legal opinion obtained as a result of recommendation 1. Fort Lewis does agree that such things as monitoring fund performance, the number and type of fund options offered by sponsors, and investment related fees of sponsors, should be done. To that end we have sought assessment of those functions by an independent financial consultant as well as our plan sponsors. However, we question whether the responsibility lies with the plan sponsors and the individual participant **or** with the higher education governing boards. Implementation date: July 1, 2003.

STATE COLLEGE SYSTEM RESPONSE:
Agree. The current contracts with the three plan sponsors stipulate that the plan administrator has the authority and responsibility to approve each and all of the investment options being offered by each fund sponsor. Each fund sponsor must submit a formal request to change the investment choices to the plan administrator. The plan administrator reviews the requested changes prior to approval or disapproval. This practice has been in place since May 1, 1994. The proposed advisory committee will become involved in the monitoring and review process during the 2003-2004 fiscal year and will advise the plan administrator of potential future changes.

UNIVERSITY OF COLORADO RESPONSE:
Agree. The University of Colorado will, based on the results of the actions taken in response to recommendations number 1 and 2, implement an appropriate level of monitoring and directing of the number and types of fund options offered by sponsors. Such monitoring and directing is anticipated to commence no later than December 31, 2003, in conjunction with the formation of the oversight body created in the response to recommendation number 2.

UNIVERSITY OF NORTHERN COLORADO RESPONSE:
Agree. A retirement board would review and recommend options to be offered by sponsors and negotiate contracts with sponsors. Depending on the outcome of recommendations 1 & 2, we would implement this change no later than December 31, 2003.

ROUTINE REVIEW OF INVESTMENT FUNDS HELPS PARTICIPANTS ACHIEVE RETIREMENT GOALS

One of the duties of a DC plan administrator is to monitor fund performance and take appropriate action when funds are not performing favorably compared to benchmarks. For example, Colorado's 457 Deferred Compensation Committee annually reviews the performance of each of the funds in the Deferred Compensation Plan. When a fund under-performs compared to its benchmark or peer for a pre-determined period of time, the fund is put on "watch" by the Committee. Plan participants are notified of the fund's "watch" status and the Committee continues to review the fund quarterly. If the fund continues to under-perform for two consecutive quarters, the Committee may terminate the fund and search for a replacement.

Reviewing fund performance and taking actions based on that review will help plan members achieve their retirement goals by ensuring they are offered funds that perform well relative to their benchmarks. However, through our review, we found the higher education institutions do not have formal investment policies and do not routinely review investment fund options. The investment decisions are left to the member to select one fund sponsor, and direct contributions into the funds offered by that fund sponsor. The policy used by each institution for selecting and monitoring fund sponsors and investment funds can be summarized as follows:

- *CU* – Does not limit the choice of funds within each fund sponsor, and does not direct and/or designate specific funds, but rather leaves these decisions to members. CU last performed a search for fund sponsors in 2000. No new fund sponsors were added and none were replaced.

- *CSU* – Limits the funds the fund sponsors can offer and no new funds can be offered unless CSU authorizes them. CSU last performed a search for fund sponsors in 1993 when the plan was first implemented.

- *UNC* – Does not limit the funds offered by the fund sponsors. Each member determines how to invest his or her funds with the help of the fund sponsor. UNC last performed a search for fund sponsors in 1993 when the plan was first implemented.

- *State Colleges* – Fund sponsors are responsible for reviewing and selecting fund offerings. The Plan Administrator randomly reviews the investment performance of the fund sponsors and compares the performance to industry standards. The Plan Administrator has authority to change fund sponsors. The State Colleges last performed a search for fund sponsors in 1994 when the plan was first implemented. Three investment companies were selected that have experience with higher education clients.

- *USC* – Does not limit the funds offered by the fund sponsors. Each member determines how to invest his or her funds with the help of the fund sponsor. USC last performed a search for fund sponsors in 1993 when the plan was first implemented.

- *Ft. Lewis College* – All funds of the fund sponsors are currently offered to members. An internal committee periodically contracts for an independent review of fund sponsors and investment fund offerings to assure the offerings remain competitive and appropriate. Ft. Lewis last performed a search for fund sponsors in 1994 when the plan was first implemented. A review of the investment options was performed in 1998 by an independent consulting firm that found the plan provided a wide range of appropriate investment choices.

Although the ORPs are not subject to the requirements of Title I of the Employee Retirement Income Security Act of 1974 (ERISA), the Act provides useful guidance for retirement plan fiduciaries. For example, ERISA requires plans to have funding policies to determine short- and long-term financial needs and an investment policy that is coordinated with the funding policy. ERISA also requires that fiduciaries act prudently in choosing to delegate responsibilities such as plan administration and investment management and document their decisions regarding the delegation of such functions. The higher education institutions should be guided by ERISA in managing their ORPs and selecting fund sponsors.

Historical Performance Ratings

We evaluated the funds offered by each sponsor to identify which fund slates have generally strong investment performance and which fund slates have performance concerns that should be investigated further. As such, our performance analysis was very broad in nature. We compared each fund's 3- and 5-year average annualized total returns to a relevant index and a peer group. The fund returns were reported net of investment-related fees such as management fees, trading costs, research, mortality and expense fees, and distribution costs. Funds with high expense ratios tend to underperform their peers due to the effect of the high costs. We did not rate funds with track records of less than three years.

The assessment of performance is described below.

Poor performance includes:

- funds that under-performed both benchmarks (index and peer group) over both the 3- and 5-year period
- funds that under-performed both benchmarks in one period and performed between the benchmarks in the other period (e.g., outperformed relative to the index but underperformed relative to the peer group, or v.v.)

Average performance includes:

- funds that performed between the benchmarks over both the 3- and 5-year period
- funds that under-performed both benchmarks in one period and outperformed both benchmarks in the other period

Good performance includes:

- funds that outperformed both benchmarks over both the 3- and 5-year period
- funds that outperformed both benchmarks in one period and performed between the benchmarks in the other period

The following table shows the results of our analysis.

LONG-TERM INVESTMENT PERFORMANCE
Number of Funds Categorized with Poor, Average, or Good Long-Term Track Records
Based on Average Annualized Net-of-Fee Returns over the Past 3- and 5-Year Periods

	FUND PERFORMANCE			
CATEGORY	**Poor**	**Average**	**Good**	**Not Rated**
Money Market	2	2	14	
Stable Value			1	
Fixed Income	15	18	15	2
Balanced	15	1	22	2
Domestic Equity	32	25	90	18
Int'l Equity	7	6	24	2
Other	1		3	
Total	72	52	169	24
% of Total	23%	16%	53%	8%

Source: Buck Consultants analysis of investment performance using information provided by the fund sponsors and index and peer group benchmarks selected for each fund.

As the table shows, nearly one-quarter of the funds offered to ORP participants were in the poor category and just over half were in the good category. Our findings suggest that all the institutions use some fund sponsors that offer funds with strong historical investment performance but also some funds that have poor historical performance.

Currently, the institutions do not assess the performance of individual funds or of the fund sponsors, in part because they do not require routine reporting of fund information by the sponsors. As noted previously, UNC was unable to provide us with any detailed fund information from Travelers/CitiStreet when the fund sponsor did not directly provide us with requested data. The institutions should have information on the funds offered to participants, including asset allocations and fund and account balances. This kind of information is necessary to assess fund performance and ensure that plan participants are offered the best possible slate of fund offerings.

Our detailed fund analyses have been provided to the institutions.

RECOMMENDATION 4

The colleges and universities should regularly monitor fund performance against benchmarks and take appropriate action when funds under-perform. They should also monitor the overall performance of the fund sponsors by requiring sponsors to provide consolidated fund reporting to use in tracking the cash flow and assets of each plan on an ongoing basis.

COLORADO COMMISSION ON HIGHER EDUCATION RESPONSE:
Agree. Each governing board administrator should, at a minimum, establish a regular and consistent schedule for periodic review of fund performance. Implementation date: No later than the end of Fiscal Year 2004.

COLORADO STATE UNIVERSITY SYSTEM RESPONSE:
Partially agree. The degree to which fund performance is to be monitored and the proper response to the performance data are dependent upon the respective responsibilities of the plan sponsors and of the individual participants directing their own investments. The proper balance for those shared responsibilities will be determined upon the clarification of the fiduciary responsibilities of the plan sponsors anticipated from the Attorney General's analysis. Depending on the outcome of that review, we would implement this change no later than December 31, 2003.

FT. LEWIS COLLEGE RESPONSE:
Partially agree. The agreement of Fort Lewis College to recommendation 4 is dependent upon the legal opinion obtained as a result of recommendation 1. Fort Lewis does agree that such things as monitoring fund performance, the number and type of fund options offered by sponsors, and investment related fees of sponsors, should be done. To that end we have sought assessment of those functions by an independent financial consultant as well as our plan sponsors. However, we question whether the responsibility lies with the plan sponsors and the individual participant **or** with the higher education governing boards. Implementation date: July 1, 2003.

STATE COLLEGE SYSTEM RESPONSE:
Agree. The plan administrator currently has the authority to monitor the performance of the fund sponsors and their fund alternatives. Informal review has taken place by employees of the state college system since the establishment of the ORP in 1994. With the help of an advisory committee, during the 2003-2004 fiscal year, the plan administrator will develop a formal system to monitor the performance of all funds offered to the employees. Appropriate action will be taken if a fund or fund sponsor no longer meets benchmark expectations.

UNIVERSITY OF COLORADO RESPONSE:
Agree. The University of Colorado will, based on the results of the actions taken in response to recommendations number 1 and 2, implement an appropriate level of fund and/or sponsor monitoring to fulfill our fiduciary duty and oversight responsibilities. Such monitoring is anticipated to commence no later than December 31, 2003, in conjunction with the formation of the oversight body created in the response to recommendation number 2.

UNIVERSITY OF NORTHERN COLORADO RESPONSE:
Partially agree. Monitoring fund performance and responding to the performance data are dependent on the responsibilities of the fund sponsors and the individual participants directing their own investments. A retirement board could monitor the ORP sponsors and review overall performance of each sponsor. The review of the sponsors should be done on a long-term basis. Portability of retirement funds should also be considered when reviewing the funds. Depending on the outcome of the review, we would implement this change no later than December 31, 2003.

MONITOR INVESTMENT-RELATED FEES

The plan administrator designated by each ORP has the responsibility of choosing fund sponsors. Common law requires them to exercise the same care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would exercise when making decisions regarding plan management. Best practices for selecting fund sponsors include reviewing and monitoring investment-related fees.

The level of fees charged by funds affects the overall investment returns to plan participants. In conjunction with monitoring the performance of funds offered to plan members, plan administrators should consider fund fees. In determining whether to retain certain funds, for example for under-performance, the administrators should also consider the associated fees of the fund. We found no evidence that monitoring of fund fees is actively being performed by the higher education institutions.

We analyzed the annual expense ratios for each fund, taking into account the investment-related fees that are paid directly by participants and are netted from fund returns. The expense ratios include a range of different fees, including investment management fees, trading costs, research, and distribution costs. VALIC also charges a mortality and expense fee. These fees cover the cost and administration of the insurance benefit included in a variable annuity contract. The funds' expense ratios as shown in the table on page 31 are compared against two benchmarks:

- Peer group average: Each peer group includes a combination of retail and institutionally-priced mutual funds. We calculated the arithmetic average of all the funds in each category.

- Peer group's 25th percentile: A variety of 401(k) plan fund sponsors offer institutionally-priced mutual funds for plans that meet certain investment minimums. To estimate the average expense ratios for institutionally-priced mutual funds, we ranked all the expense ratios for each category from lowest to highest and identified the 25th percentile.

Our findings show that the annual expense ratios vary for different fund sponsors, in part due to different administration, distribution, and mortality and expense fees. As stated previously, high expenses negatively impact a program's overall investment performance.

EMPLOYER COST

The higher education institutions do not pay the fund sponsors for the cost of investment management or plan administration. These costs are borne by each individual's account. The investment management fees are charged as a percentage of assets and deducted from investment income, thereby reducing the rate of return. For example, a fund may have an expense ratio of 0.50%. This means the annual fee is 0.50% of the assets invested in that fund. If an employee has $10,000 invested in this fund for the year, $50 is paid from the investment income of the employees' account.

INVESTMENT-RELATED FEES[1]

CATEGORY	Average expense ratio for fund sponsors' funds in each category						
	TIAA-CREF (All ORPs)	VALIC (All ORPs except CU)	Vanguard (CU)	Fidelity (CU)	Fidelity (CSU & State College System)	Peer Group Average[3]	Peer Group's 25th Percentile[2]
Short-Term							
• Money Market	0.34%	1.46%	0.33%	0.41%	0.42%	-	-
• Stable Value	-	-	-	-	-	-	-
Fixed Income							
• Index	-	-	0.21%	0.31%	0.31%	0.34%	0.21%
• Actively-Managed	0.39%	1.54%	0.26%	0.63%	0.64%	1.12%	0.72%
Balanced	0.38%	1.19%	0.32%	0.79%	0.68%	1.30%	0.92%
Domestic Equity							
• Index	0.36%	1.43%	0.24%	0.21%	0.17%	0.76%	0.25%
• Large Cap	0.41%	1.85%	0.48%	0.79%	0.81%	1.34%	0.92%
• Mid Cap	-	2.02%	0.61%	0.66%	-	1.48%	1.06%
• Small Cap	-	2.24%	0.72%	0.96%	-	1.54%	1.15%
• Sector	-	2.05%	0.44%	1.38%	-	1.69%	1.19%
Global/Int'l							
• Index	-	-	0.39%	0.35%	-	0.98%	0.40%
• Global	0.46%	2.11%	1.08%	1.04%	-	1.79%	1.25%
• International	-	1.86%	0.63%	1.16%	1.14%	1.64%	1.17%

(1) The expense ratios are expressed as a percentage of assets. They include investment management fees, administration and distribution fees, mortality and expense fees, and other expenses.
(2) Peer group data was obtained from Morningstar. See page 31 for an explanation of the 25th percentile.

Green = fund's expense ratio is below both peer group benchmarks
Blue = fund's expense ratio is between both peer group benchmarks
Red = fund's expense ratio is above both peer group benchmarks

V. OVERSIGHT OF THE ORPS

As mentioned previously, the fund sponsors for the ORPs provide "bundled" services, which means the investment management, custody, and administrative services are combined, or bundled. Each higher education institution uses either two or three bundled providers, constituting multiple-bundled arrangements. Multiple-bundled arrangements are common for 403(b) Tax-Sheltered Annuity plans and 457 Deferred Compensation plans. These types of plans are frequently offered to employees of educational institutions and other government agencies as additional retirement savings plans to supplement the retirement benefit provided by the employer's 401(a) retirement plan, whether that is a defined benefit plan or a defined contribution plan. Employers normally do not contribute to 403(b) or 457 plans, and have a diminished role in their administration and operation. It is rare for 401(a) defined contribution plans to use multiple-bundled arrangements because of their mandatory nature, which imposes greater fiduciary responsibility on the plan sponsors. The fiduciary duty includes monitoring investment performance and fees and replacing funds that underperform, which is best accomplished when the plan sponsor is able to negotiate fees and fund offerings independently with each fund sponsor.

Bundled arrangements are very common for small to mid-sized retirement plans. Employers with these size plans have limited staff to perform administrative functions and the relatively small asset size of the plans eliminates the ability to use institutional funds with lower investment management fees. The cost per head for administration can be prohibitive for smaller plans unless a bundled approach is used. Bundled service providers are generally willing to discount administrative fees because of the lucrative retail fees collected on the investment management.

An unbundled arrangement is where the administrative services are contracted separately from the investment funds. Many larger plans are able to take advantage of unbundled arrangements because 1) there is greater buying power, and 2) the cost per head for administration decreases with the number of participants.

A major disadvantage of bundled services is that they have inherent limitations as one-stop shopping arrangements. They do not allow the plan administrator to choose the best funds and service providers using a competitive bid process. If an investment fund or service provider is found to be under-performing, rather than replacing just that fund or provider, the entire structure must be changed. Using an unbundled arrangement would address all these drawbacks, but would generate higher fees to each of the individual ORPs unless institutional funds with lower fee schedules could be used.

One approach to obtaining lower fees through unbundled services would be for the higher education institutions to combine their plans into fewer ORPs that serve multiple institutions. This would make the provision of unbundled services more cost effective by creating a large asset pool. Institutional funds with lower fee schedules could then be used. Combining some or all of the ORPs and reducing their number would also reduce the expenses associated with oversight and administration. A collective approach such as this would not preclude different levels of contributions.

RECOMMENDATION 5

The colleges and universities should take steps to obtain more favorable contractual terms and conditions from their fund sponsors. The institutions should:

a. Implement procedures to regularly monitor and manage investment-related fees.

b. Consider collectively offering a smaller number of ORPs to permit the use of unbundled arrangements leading to more favorable expense ratios and use of the best performing fund offerings.

COLORADO COMMISSION ON HIGHER EDUCATION RESPONSE:
Agree. The governing board should not only examine the number of offerings, but also consider whether PERA should be an option for some of these covered employees to reduce costs to these institutions and possibly enhance retirement benefits for employees. Implementation date: No later than the end of Fiscal Year 2004.

COLORADO STATE UNIVERSITY SYSTEM RESPONSE:
Partially agree. Colorado State University will work with the fund sponsors and enter into discussions with the intent of reducing fees to its participants to the extent possible. Discussion will be initiated by December 31, 2002. The second aspect of this recommendation proposes consideration of "collectively offering a smaller number of ORPs to permit the use of unbundled arrangements leading to lower fees." As clarified in the audit report's analysis of this recommendation, "unbundling" would only be possible by consolidating all existing ORPs into a single plan with common policies and employee and employer contributions. Recognizing that consolidation of this sort has serious institutional autonomy and governance implications, the Colorado State University System is prepared to discuss the implication of this option and its viability with the other institutions offering ORPs.

FT. LEWIS COLLEGE RESPONSE:
Partially Agree. The agreement of Fort Lewis College to recommendation 5 is dependent upon the legal opinion obtained as a result of recommendation 1. Fort Lewis does agree that such things as monitoring fund performance, the number and type of fund options offered by sponsors, and investment related fees of sponsors, should be done. To that end we have sought assessment of those functions by an independent financial consultant as well as our plan sponsors. However, we question whether the responsibility lies with the plan sponsors and the individual participant **or** with the higher education governing boards. Implementation date: July 1, 2003.

STATE COLLEGE SYSTEM RESPONSE:
Partially Agree. The advisory committee will monitor and conduct reviews of appropriate levels of fund sponsor fees and make recommendations to change the upcoming contracts with each fund sponsor if a particular fee is felt to be too high. The advisory committee can review the pros and cons of "bundled" versus "unbundled" arrangements that the state colleges has with the fund sponsors and determine if there would be substantial financial savings to move toward "unbundling" a portion of the services. Please also see response to Recommendation #2. Implementation date: Fiscal Year 2004.

UNIVERSITY OF COLORADO RESPONSE:
Agree. The oversight body established in response to recommendation number 2, consistent with its fiduciary duty and oversight responsibilities established in response to recommendation number 1, will seek contractual arrangements that will benefit the plan participants. Such actions are anticipated to commence no later than December 31, 2003, in conjunction with the formation of the oversight body created in the response to recommendation number 2.

UNIVERSITY OF NORTHERN COLORADO RESPONSE:
Partially Agree. A Retirement Board would determine which ORP sponsors would be selected and would monitor fees of sponsors. The board would have more purchasing power to negotiate lower fees. Depending on establishing a retirement board, we would anticipate implementation by December 31, 2003.

ASSET ALLOCATION, BENEFIT ADEQUACY, AND EDUCATION OF PLAN MEMBERS

Because a DC plan shifts responsibility for investment decisions, education of members is critical to help them manage their investments so that they are able to achieve their retirement goals. We examined how ORP participants allocate their assets, on average, as a preface to analyzing benefit adequacy and evaluating the education being provided to plan members.

ASSET ALLOCATION

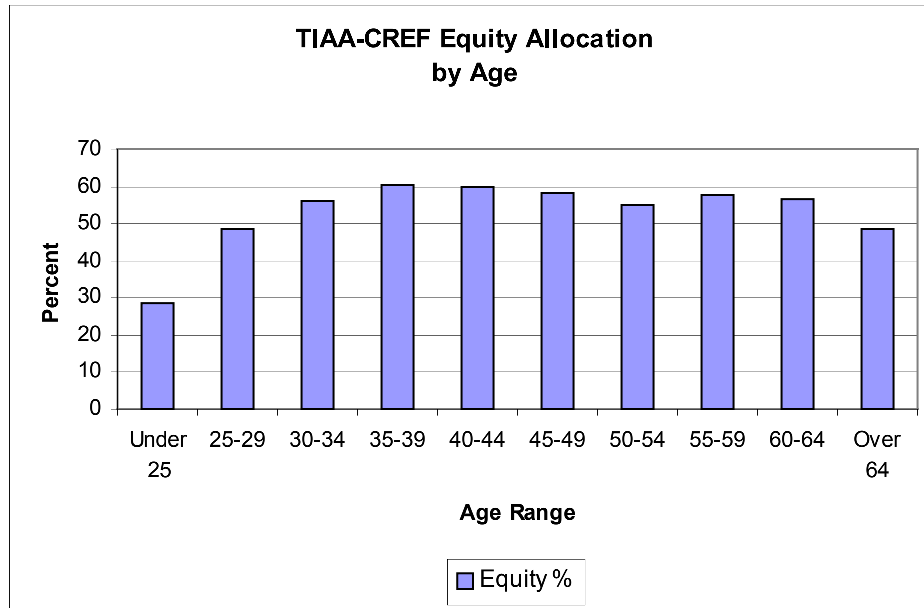
Fund sponsors offer eligible employees a wide range of funds in which to invest their money. We reviewed records from the fund sponsors to determine how employees are allocating their money between equity funds and all other funds. We separated the allocations into equity and other investments to gauge the level of risk ORP members are taking, and the level of return expected over the long term. We identified the equity funds offered by each fund sponsor and determined the percentage of each employee's account invested in equities. The average equity allocation of employee account balances by fund sponsor is:

- TIAA-CREF 56.4%
- VALIC 70.2%
- Fidelity 70.6%
- Vanguard 81.5%

The average equity allocation of employee account balances by higher education institution is:

- CSU 66.2%
- Ft. Lewis 53.8%
- State Colleges 67.4%
- CU 66.8%
- UNC 67.1%
- USC 57.3%

In order to see how the allocation to equity varied by age, we selected TIAA-CREF data because of the availability of ages and the manageable number of funds offered. The following graph shows the equity allocation by age in five-year age ranges:



The allocation by age indicates there is not much of a correlation between age and equity allocation or investment risk. Most of the average equity allocations are between 50% and 60% of the total account balance with lower allocations to equity for employees below age 30 and over age 64. This does not mean that most people individually are allocating 50% to 60% of their accounts in equities, but rather that across the entire population of investors there are a fairly equal number of risk takers and conservative investors for employees aged 30 to 64. The distribution of equity allocation by quartile follows:

Equity Allocation	Percent of ORP Members
0% - 25%	25%
25% - 50%	19%
51% - 75%	23%
76% - 100%	33%

BENEFIT ADEQUACY

We measure benefit adequacy by the ability of the retirement benefit to keep a retired employee at the same standard of living that the employee enjoyed just prior to retirement. The adequacy level is expressed as a percent of salary the employee was receiving just prior to retirement. Because retired employees no longer need to save for retirement or pay Social Security taxes (in the case of a CU employee), the income need in retirement is less than the full salary earned just prior to retirement.

For ORP members except CU, we determined that this means a retirement income of 85% to 90% of their salary just prior to retirement will be needed to maintain the same standard of living. For a CU employee, who is also covered by Social Security, the amount is 75% to 80% of final salary. It should be noted that annual increases in the retirement income for inflation beyond the first year are needed to keep a retiree at the same standard of living.

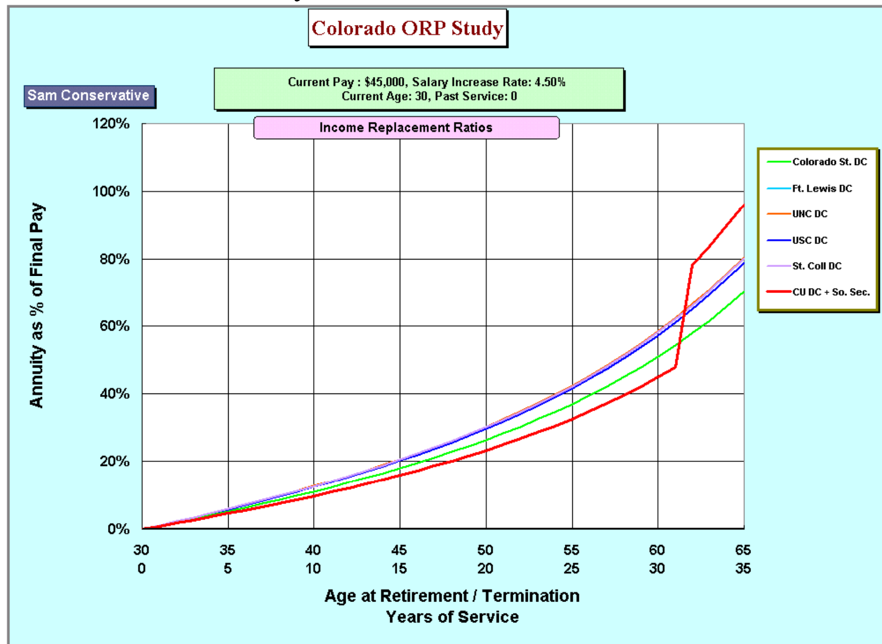
To measure the ability of the ORPs to deliver a retirement benefit that meets benefit adequacy, we projected account balances for three hypothetical ORP members. We assumed they begin participating in the ORP at age 30, earn a starting annual salary of $45,000 with salary increasing at 4.5% per year, and retire at age 65 after 35 years of service. We also assumed the equity funds would earn a 9.0% rate of return and the fixed income funds would earn a 5.0% rate of return annually, net of all investment and administrative expenses, over the 35 year service period. The three ORP members invest their account balances as follows:

- Sam Conservative is a conservative investor with 20% of his account in equities and 80% in fixed income.
- Sam Average is an average investor with 60% of his account in equities and 40% in fixed income.
- Sam Aggressive is an aggressive investor and has 80% of his account invested in equities and 20% in fixed income.

Purchase of Annuity

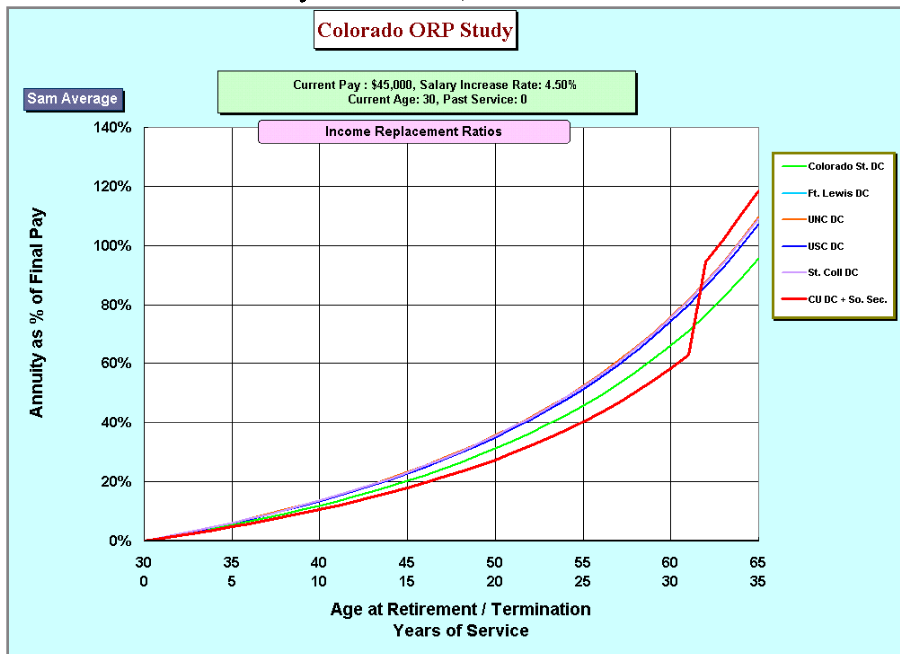
The first set of charts below assumes that, upon retirement, all three investors purchase an annuity that provides income guaranteed for their lifetime. To determine the amount of the annuity, we used an annuity purchase rate comparable to the annuities available by TIAA-CREF and VALIC. The retirement benefit projected for Sam Conservative, considering the ORP contribution amounts for each of the higher education institutions, is shown in the following graph. It shows that only the CU benefit meets benefit adequacy of a conservative investor at retirement because employees in the CU ORP also participate in Social Security.

Annuity Purchase; No COLA



The retirement benefit projected for Sam Average, considering the ORP contribution amounts for each of the higher education institutions, is shown in the following graph. It shows that all ORPs meet benefit adequacy of an average investor at retirement.

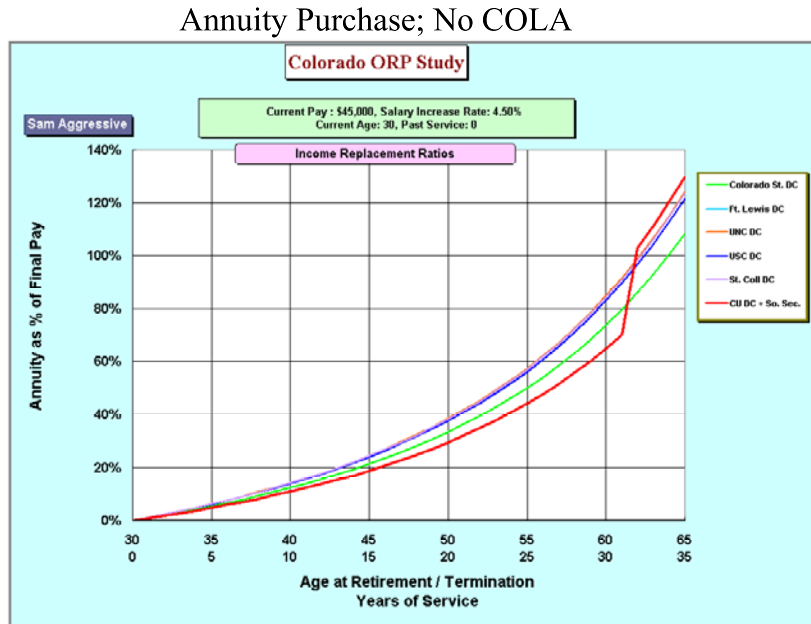
Annuity Purchase; No COLA



V. OVERSIGHT OF THE ORPS

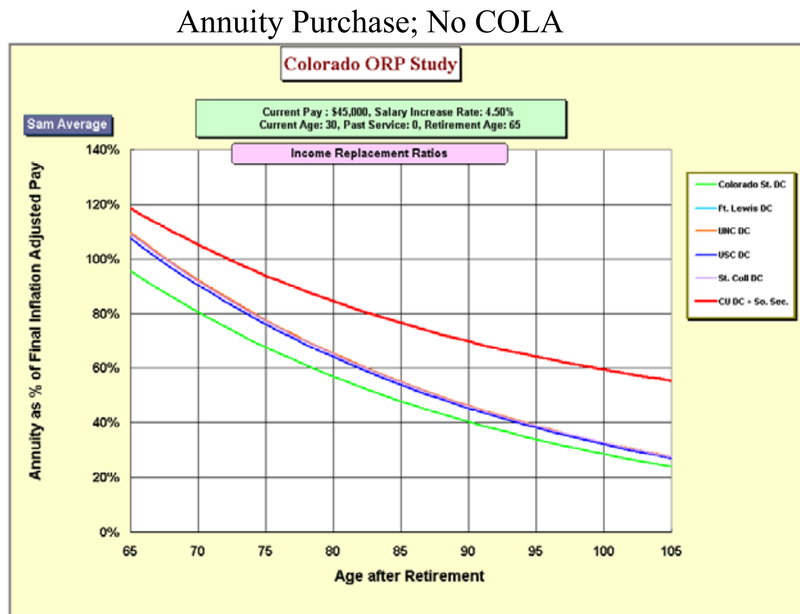
The retirement benefit projected for Sam Aggressive, considering the ORP contribution amounts for each of the higher education institutions, is shown in the following graph. It shows that all ORPs meet benefit adequacy of an aggressive investor at retirement.

Annuity Purchase; No COLA



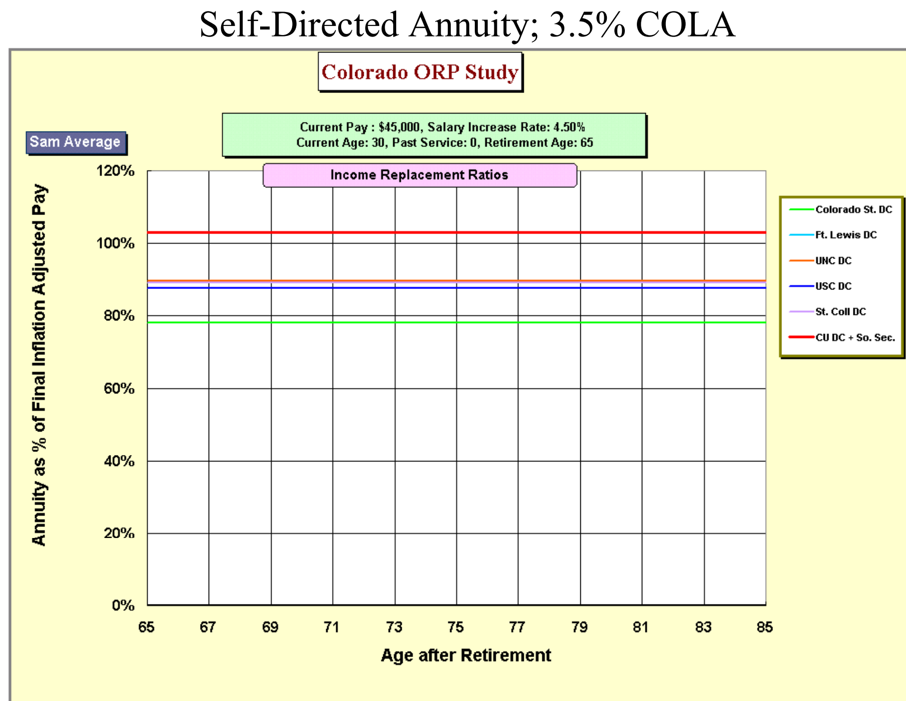
Our analysis generally indicates that the ORPs will provide an adequate benefit for average or aggressive investors, but not for a conservative investor. However, a further consideration is that the annuities do not increase during retirement for cost-of-living. Without annual increases, the purchasing power of the annuity payments will decrease over time. The following graph shows the diminishing purchasing power of the annuity for Sam Average if inflation is 3.5% per year. Life expectancy at age 65 is about 21 years for females and 18 years for males. The CU benefit will remain adequate until age 90, or 4 to 7 years beyond average life expectancy. The benefit provided by the other ORPs falls below the 85% adequacy level by age 73.

Annuity Purchase; No COLA



PAYMENTS AFTER RETIREMENT

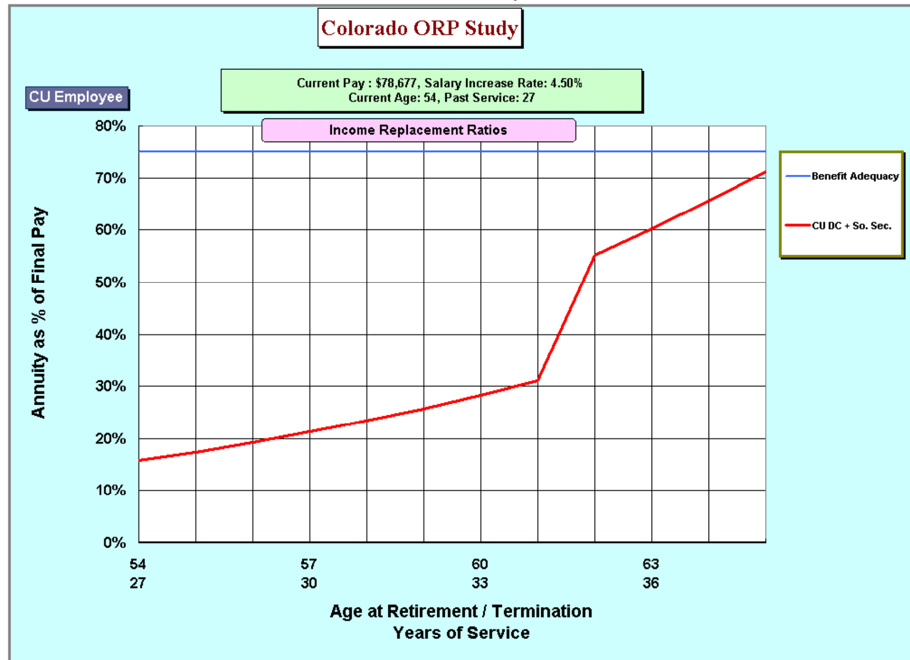
Instead of purchasing an annuity, a retiring employee could elect to receive payments directly from the account. If the payments deducted from the account are increased each year by 3.5%, assuming the payments meet minimum distribution rules, the retiree can receive payments with cost-of-living protection. We have assumed Sam Average chooses this approach and has adjusted his asset allocation in retirement to a more conservative 40% equity, 60% fixed income portfolio. The following graph shows the benefit is adequate at and during retirement until age 85. It should be noted that if Sam lives longer than his life expectancy, he will either run out of money or need to reduce his payment amount before death.



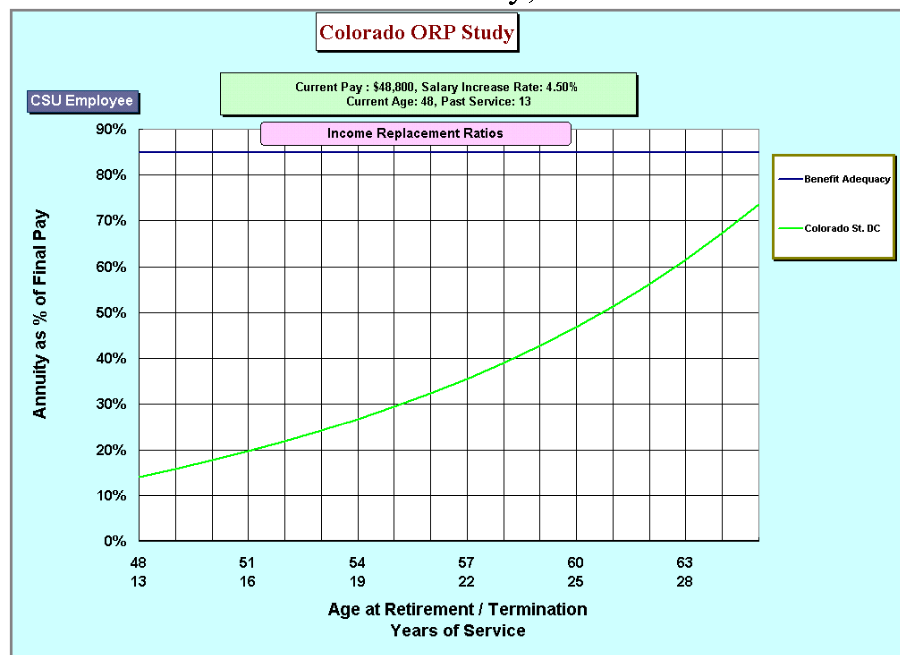
ANALYSIS OF ACTUAL ORP MEMBERS

We also performed a benefit adequacy analysis on a small sample of actual ORP members. To do this, five ORP members per fund sponsor per higher education institution were selected and date of birth, date of hire, and annual salary information was requested from the corresponding institution. Few of the members sampled were projected to achieve benefit adequacy by age 65. The following two members were typical of those sampled.

Self-Directed Annuity; 3.5% COLA



Self-Directed Annuity; 3.5% COLA



V. OVERSIGHT OF THE ORPS

We can conclude from our analysis that the ORP benefit can be adequate to maintain a retiree's standard of living, but only for investors who are willing to assume sufficient risk to achieve the necessary investment return. The CU benefit is best for participants because its ORP members also participate in Social Security, although its contribution levels are higher. However, as shown by the Sam Conservative charts and the analysis of actual ORP members, some participants will fall short of the adequacy level due to poor investment decisions or shorter working careers. Although the higher education institutions cannot affect the length of an employee's career, they can maximize the chance ORP members have to achieve benefit adequacy by overseeing and directing the number and types of fund options available, taking steps to minimize expenses, and providing education to employees.

EMPLOYEE EDUCATION

One way to increase the ability of ORP participants to allocate their assets so that they achieve benefit adequacy is by providing them with investor education. Elements of a good communication and education program for DC plan members include:

- Summary plan descriptions
- Fund prospectuses
- Employee meetings
- Benefit brochures
- Personalized statements or projections
- Quarterly newsletters
- Toll-free hotline
- Workshops or seminars
- Retirement planning software
- Individual counseling
- Videos

ERISA states informing employees of all relevant information regarding the plan is the "core" of a fiduciary's responsibility. Fiduciaries must provide information to employees that is complete, correct, and understandable.

THE HIGHER EDUCATION INSTITUTIONS SHOULD EXPAND INDEPENDENT EDUCATIONAL EFFORTS

We found the higher education institutions with ORPs rely primarily on the fund sponsors to provide education to participants, as provided by the various contracts. All fund sponsors provide educational services that include toll-free participant service centers and websites. In addition, most of the institutions provide some direct education, most commonly in the form of annual workshops or seminars to discuss financial management, including retirement planning. However, it is important for all the institutions to provide education and information that is independent of the fund sponsors. Education should assist members to make choices regarding which fund sponsors to use, which funds to select, and how to allocate their assets among various fund categories. Ideally, retirement planning seminars facilitated by an independent expert would be offered regularly to explain investments offered by the various fund sponsors,

retirement income needs, and establishing a retirement plan for meeting those needs. Educational efforts are particularly essential to ensure plan participants understand the ramifications of their investment choices and choose an investment approach that is consistent with their tolerance for risk yet also ensures benefit adequacy at retirement.

RECOMMENDATION 6

The higher education institutions should expand their educational efforts for their employees participating in the ORPs. This should consist of annual employee meetings presented by an investment expert independent of the fund sponsors, covering such topics as types of investments, asset allocation theory, risk and return, and retirement income needs. Educational efforts of the fund sponsors can supplement the educational program provided by the plan sponsors.

COLORADO COMMISSION ON HIGHER EDUCATION RESPONSE:
Agree. Increasing the information available to plan participants should increase awareness of retirement options available to plan participants. Additionally, governing boards should consider the costs and benefits to move some portion of these employees to PERA. Implementation date: July 2003.

COLORADO STATE UNIVERSITY SYSTEM RESPONSE:
Agree. Implemented at Colorado State University currently provides relevant information to its ORP participants in several forms. Our Summary Plan document contains information on basic investing covering such area as goal setting, risk/return analysis and diversification. Our annual Benefits Fair allows plan participants the opportunity to meet with representatives of our three fund sponsors (Fidelity, MetLife, TIAA-CREF, and VALIC) and compare services and investment options. Finally, our annual financial and retirement planning workshop curriculum includes sessions on estate planning, investment strategies, goal setting and risk/return analysis with presentations by fund sponsor representatives and private estate counselors.

Similar educational efforts are undertaken at the University of Southern Colorado. The University of Southern Colorado will make use of independent investment experts at the next educational seminar.

FT. LEWIS COLLEGE RESPONSE:
Agree. Fort Lewis College agrees that each institution has some responsibility for giving individual ORP participants opportunities to become more informed about their options regarding the ORP. To this end Fort Lewis College has offered seminars each year relating to the financial aspects of retirement planning. Implementation date: July 1, 2003.

STATE COLLEGE SYSTEM RESPONSE:
Partially agree. The advisory committee and the plan administrator will evaluate the recommendation to have an independent investment expert provide information to employees participating in an ORP. We have used similar counselors in the past and have found these individuals inadequate to answer specific questions about each of the ORPs. We would consider using an individual investment expert in conjunction with presentations by each of our fund sponsors. Implementation date: Fiscal Year 2004.

UNIVERSITY OF COLORADO RESPONSE:
Agree. The University of Colorado will expand its educational offerings for its employees participating in its ORP. These educational offerings will be presented by investment experts independent of the fund sponsors, and will cover the topics suggested in the recommendation. Offerings will commence in November 2002 and will occur at least annually.

UNIVERSITY OF NORTHERN COLORADO RESPONSE:
Partially agree. Currently, University of Northern Colorado provides training on ORPs done by sponsor representatives. University of Northern Colorado schedules time for sponsor representatives to come and talk to employees. The expertise of the fund sponsors, those in the business, are generally more informed and more current than University of Northern Colorado staff. In addition, during these economic times it may not be feasible to expend funds to hire consultants to duplicate the information being provided by the fund sponsors. Depending on the views of a retirement board, if formed, University of Northern Colorado would increase training options by December 31, 2003.

APPENDIX A
SUMMARIES OF MEMBER BALANCES AND ASSET ALLOCATION

	TIAA-CREFF	VALIC	Vanguard	Fidelity	Travelers CitiStreet	TOTAL
Colorado State						
Count	2,363	1,037		2,137		5,537
Total Balance	$ 62,136,993	$ 35,800,890		$ 70,913,443		$ 168,851,326
Avg Balance	$ 26,295.81	$ 34,523.52		$ 33,183.64		$ 30,495.09
Univ. of Colorado						
Count	4,582		2,111	2,037		8,730
Total Balance	$ 321,420,240		$ 50,119,397	$ 47,319,653		$ 418,859,290
Avg Balance	$ 70,148.46		$ 23,742.02	$ 23,230.07		$ 47,979.30
State Colleges						
Count	740	243		326		1,309
Total Balance	$ 21,660,479	$ 11,473,320		$ 12,820,046		$ 45,953,845
Avg Balance	$ 29,270.92	$ 47,215.31		$ 39,325.29		$ 35,106.07
Fort Lewis						
Count	540	57				597
Total Balance	$ 6,296,831	$ 946,060				$ 7,242,891
Avg Balance	$ 11,660.80	$ 16,597.54				$ 12,132.15
Northern Colorado						
Count	928	482			23	1,433
Total Balance	$ 22,959,095	$ 12,530,779			$ 500,000	$ 35,989,874
Avg Balance	$ 24,740.40	$ 25,997.47			$ 21,739.13	$ 25,115.06
Southern Colorado						
Count	813	264				1,077
Total Balance	$ 6,876,989	$ 5,393,467				$ 12,270,456
Avg Balance	$ 8,458.78	$ 20,429.80				$ 11,393.18
TOTAL						
Count	9,966	2,083	2,111	4,500	23	18,683
Total Balance	$ 441,350,627	$ 66,144,516	$ 50,119,397	$ 131,053,142	$ 500,000	$ 689,167,682
Avg Balance	$ 44,285.63	$ 31,754.45	$ 23,742.02	$ 29,122.92	$ 21,739.13	$ 36,887.42

NOTES: Includes inactive members who are no longer contributing.
* Estimated.

Source: Buck Consultants summary and analysis of information provided by fund sponsors.

APPENDIX B
SUMMARY OF PLAN PROVISIONS AND ADMINISTRATIVE POLICIES

Provisions	Colorado State University	University of Colorado	State Colleges	University of Northern Colorado	University of Southern Colorado	Ft. Lewis College
PLAN PROVISIONS						
Plan Type	401(a) Money Purchase Plan	401(a) Money Purchase Plan	401(a) Money Purchase Plan	401(a) Money Purchase Plan	401(a) Money Purchase Plan	401(a) Money Purchase Plan
Date Plan Established	April 1, 1993	January 1, 1924	May 1, 1994	March 1, 1993	May 1, 1994	October 1, 1994
Plan Eligibility (PERA participants excluded from all plans)	Employee of the University or Colorado State Board of Agriculture with a general faculty, post-doctoral or veterinary intern appointment	University faculty, officer or administrator	Employee of the University who is exempt from Colorado state personnel system under either Section 13(2) of Article XII of the Colorado Constitution of Section 24-50-135 of the Colorado Revised Statutes and who meets eligibility criteria in Section 4.23 of the employers Trustee Policy Manual	Employee of the University who is exempt from Colorado state personnel system under either Section 13(2) of Article XII of the Colorado Constitution or Section 24-50-135 of the Colorado Revised Statutes	Employee of the University with an academic faculty, administrative faculty or professional staff regular or term assignment	Faculty and exempt staff
Normal Retirement Age/Service	Age 55	Age 55	Age 55	Age 65	Age 55	Age 55
Employee Contributions (mandatory, "picked up" by employer)	8.00%	5% (11.2% including Social Security)	8.00%	8.00%	8.00%	8.00%
Employee Contributions (voluntary)*	None permitted	None permitted	None permitted	None permitted	None permitted	None permitted
Employer Contributions	9% (additional 2.6% to subsidize retiree medical)	10% (16.2% including Social Security)	11.40%	11.50%	11.10%	11.40%
Vesting	100% immediate	100% immediate	100% immediate	100% immediate	100% immediate	100% immediate
Valuation Frequency	At least quarterly	At least quarterly	At least quarterly	At least quarterly	At least quarterly	At least quarterly
How often may employee change:						
Funds within Fund Sponsor	According to Fund Sponsor rules	According to Fund Sponsor rules	According to Fund Sponsor rules	According to Fund Sponsor rules	According to Fund Sponsor rules	According to Fund Sponsor rules
Fund Allocation to Fund Sponsors	Once per year during designated open enrollment period	According to Fund Sponsor and University rules	Once per year during designated open enrollment period	According to Fund Sponsor rules	Once per year during designated open enrollment period	Once per year during designated open enrollment period
Forms of Distribution	Lump sum, installments, Annuity, Direct Rollover	Lump Sum, Installments, Annuity, Direct Rollover – Any combination of options may be elected	Lump Sum, Installments, Annuity, Direct Rollover – Partial Distribution – Any other method authorized by fund sponsor	Lump Sum, Installments, Annuity, Direct Rollover – Partial Distribution – Any other method authorized by fund sponsor	Lump Sum, Installments, Annuity, Direct Rollover	Lump Sum, Installments, Annuity, Direct Rollover
Loans	Max Amt: Greater of $10,000 or ½ of account balance, but not greater than $50,000 minus other loan balances	None permitted	None	Max Amt: Greater of $10,000 or ½ of account balance, but not greater than $50,000 minus other loan balances Interest charged: administrator rules	Max Amt: Lesser of ½ of account balance, or $50,000 minus other loan balances Interest charged: fund sponsor rules	Max Amt: sponsor rules
In service/Hardship Withdrawals	None	None	None	None	None	None
Accept Rollover/Transfer Contributions?	Yes	Yes	Yes	Yes	Yes	Yes
Social Security Coverage	None, except Medicare	Yes, including Medicare	None, except Medicare	None, except Medicare	None, except Medicare	None, except Medicare

*Voluntary contributions are not eligible to be made on a pre-tax basis, so are typically not permitted.

Provisions	Colorado State University	University of Colorado	State Colleges	University of Northern Colorado	University of Southern Colorado	Ft. Lewis College
PLAN POLICIES AND ADMINISTRATION Administrator	The employer, Colorado State University Benefits Director and Benefits Manager	University of Colorado – System Administration – with approval of a majority of the University of Colorado Board of Regents	Trustees of the State Colleges in Colorado Vice President for Administration and Finance	Person, persons or entity designated by UNC One or more of Fund Sponsors will have some or all of plan administrators duties and powers. In case of conflict, Fund sponsor alone will act	The employer, University of Southern Colorado Plan Sponsor: Vice President Finance & Administration Plan Administrator: Director of Human Relations/Affirmative Action	The employer, Ft. Lewis College Vice President for Business and Finance
Staff Member who Coordinates with Fund Sponsors & Board	Benefits Manager	Director of Benefits	Vice President of Administration and Finance and Director of Management Services	Sr. Vice President, Finance and Administration	Director of Human Relations/Affirmative Action and Employee Relations Benefits Coordinator	Human Resource Specialist
Fund Sponsors	TIAA-CREF Fidelity VALIC	TIAA-CREF Vanguard Fidelity	TIAA-CREF Fidelity VALIC	TIAA-CREF Travelers/CitiStreet VALIC	TIAA-CREF VALIC	TIAA-CREF VALIC
Investment Policy/Rules for: Monitoring Fund Perform. Measuring Fund Perform. Replacing under-performing funds Fund Benchmarks	Limits the funds fund sponsors can offer.	Administers plan with three of the largest fund sponsors available. Any fund made available to the plan by the fund sponsor is available to participants. The University does not direct and/or designate specific funds, rather leaves these decisions to participants.	Information not provided	Information not provided	Investments are monitored and measured by each fund sponsor with individualized planning and investing	An internal committee periodically contracts for an independent review of fund sponsors and their investment offerings to assure they remain competitive and appropriate. Among items considered are risk, rate of return, expenses, financial stability and service to employees and Ft. Lewis College. Provider and investment fund performance is measured against several industry criteria including independent rating firms and market indexes appropriate for the objective of the particular investment option.
Last Fund sponsor Search	1993 when ORP implemented - no further searches	2000, no fund sponsors were replaced	1994 when ORP implemented - no further searches.	1993 when ORP implemented - no further searches.	1993 when ORP implemented - no further searches.	1994 when ORP implemented - no further searches.

APPENDIX C
FIDUCIARY RULES UNDER ERISA

A person is a fiduciary with respect to a retirement plan to the extent he or she:

- exercises discretionary authority or discretionary control with respect to management of the plan;
- exercises any authority or control with respect to management or disposition of plan assets;
- renders investment advice for a fee or other compensation, direct or indirect, with respect to plan assets, or has any authority of responsibility to do so; or
- has any discretionary authority or discretionary responsibility in the administration of the plan.

The test for determining fiduciary status is a functional one; that is, if a person has any of the authority, discretion or control or exercises any such authority, discretion or control, that person is a fiduciary, regardless of his or her job title or official job description. The definition of fiduciary, therefore, is quite broad. However, a person is a fiduciary only with respect to those areas where he or she has the requisite authority or discretion. For example, a person who is a fiduciary solely because he or she has discretion in connection with plan administration will not be a fiduciary with regard to plan investments and will have no fiduciary liability in connection with plan investments (other than possible liability as a co-fiduciary).

Those persons who perform merely "ministerial" functions, acting only within guidelines and under procedures set by others, and with no power of their own to make policy decisions or interpret plan provisions, are not fiduciaries. See DOL Reg. §2509.75-8. The Department of Labor's regulation lists the following examples of "ministerial" functions:

- Application of rules to determine eligibility for participation or benefits;
- Calculation of service and compensation for benefit purposes;
- Preparing communications to employees;
- Maintaining participants' service and employment records;
- Preparing reports required by government agencies;
- Calculating benefits;
- Explaining the Plan to new participants and advising participants of their rights and options under the Plan;
- Collecting contributions and applying them as specified in the statutes;
- Preparing reports covering participants' benefits;
- Processing claims; and
- Making recommendations to others for decisions with respect to plan administration.

Even though employees performing ministerial functions may not be fiduciaries, the fiduciaries who hire and supervise those employees are liable for the actions or inactions of those employees under prudence rules. For example, if a fiduciary supervises an employee who merely processes benefit claims, the fiduciary must, under prudence rules, check periodically to make sure the claims are being processed correctly, in accordance with the Plan's provisions and the fiduciary's

guidelines. If such periodic checks are not made and claims are processed improperly, the fiduciary is responsible.

FIDUCIARY LIABILITY

A Plan fiduciary who fails to comply with fiduciary standards can be held personally liable for any loss suffered by the Plan due to his breach of fiduciary duty, and any profits obtained by the fiduciary through the use of the Plan's assets must be given to the Plan. The fiduciary may also face liability for his action or inaction in the face of another fiduciary's breach of duty. This personal liability probably does not extend to the State, but care should be taken to protect individuals from personal liability.

CO-FIDUCIARY LIABILITY

Not only will a fiduciary be liable for any losses resulting from a failure to act in accordance with standards of fiduciary conduct, he may also be liable for losses resulting from a breach of fiduciary responsibility by another fiduciary if:

- the fiduciary knowingly participates in or conceals such breach;
- the fiduciary's own breach enables another fiduciary to commit such breach; or
- the fiduciary has knowledge of such breach and fails to take reasonable steps to remedy it.

An example of the steps a fiduciary should take to protect himself or herself against co-fiduciary liability is contained in DOL Reg. §2509.75-5, FR-10. According to the example, the fiduciary would have to take all reasonable and legal steps to prevent the imprudent action or to remedy the breach of fiduciary duty if it has already occurred. These steps could include obtaining an injunction, selling any imprudently acquired assets, notifying the Department of Labor or publicizing the results of the meeting where the decision to take the imprudent action is reached. Mere resignation, without taking any other steps, would not be sufficient to avoid liability. In addition, the fiduciary should make sure the minutes of any meeting where the imprudent action is discussed reflect the fiduciary's objection to the action and the reason for his or her objection.

GENERAL FIDUCIARY STANDARDS

Fiduciaries must perform their duties in accordance with the terms of the "exclusive purpose rule" and the "prudent person" rule. In addition, they are required to comply with certain diversification and operation requirements and to avoid "prohibited transactions." These same fiduciary standards apply to any investment manager managing the Plans' assets.

EXCLUSIVE PURPOSE RULE

Under the exclusive purpose rule, any fiduciaries must perform their functions "solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan." For example, investment managers, and other parties retained to perform services for a Plan, must be chosen solely with the interests of Plan participants and beneficiaries in mind.

Under the exclusive purpose rule, the Plans' fiduciaries have a duty to act with undivided loyalty to the Plans' participants and beneficiaries or, as the U.S. Court of Appeals for the Second Circuit stated in Donovan v. Bierwirth, "with an eye single" to the interests of the participants and beneficiaries. This does not mean that fiduciaries violate their fiduciary duties by taking an action which, after careful, thorough and impartial investigation, they reasonably conclude best promotes the interests of Plan participants and beneficiaries simply because the same action incidentally benefits the fiduciary. It does mean that in any case where a fiduciary faces conflicting loyalties, it must be sure that the participants' interests are very carefully considered. At the very least, the fiduciaries should engage independent advisors to investigate the alternatives when faced with a potential conflict of interest and, in some cases, the fiduciaries should consider resigning or disqualifying themselves from any relevant decision.

The exclusive purpose requirement, as well as the prudent person rule, discussed below, must be kept in mind in dealing with any requests that the Plan's investments serve social ends (e.g. – divesting from corporations operating in South Africa) other than the interests of the Plan's participants.

PRUDENT PERSON RULE

The prudent person rule requires all fiduciaries to discharge their duties with respect to the Plans

> "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."

The prudent person rule goes to both prudence in investing the Plans' assets and prudence in the Plans' operation.

When making an investment decision, a Plan fiduciary must:

> "[give] appropriate consideration to those facts and circumstances that, given the scope of such fiduciary's investment duties, the fiduciary knows or should know are relevant to the particular investment . . . involved, including the role the investment . . . plays in the portion of the plan's investment portfolio with respect to which the fiduciary has investment duties and . . . [act] accordingly." Department of Labor Regulation §2550.404a-1.

The regulation goes on to state that the prudence of a particular investment is not determined solely by the risk level of that investment. Rather, the risk of loss involved should be compared with the opportunity for gain, and the suitability of the investment should be determined by taking into account its role in the Plan's investment portfolio as a whole. Further, Plan investments must be reasonably designed to further the purposes of the Plan and must be well diversified. Last, in evaluating investments, consideration may be given to the asset's potential for capital appreciation. It is not required that every Plan investment produce current income under all circumstances.

Of course, the Plans' fiduciaries should take care to properly document the considerations that go into their investment decisions.

It should be noted that a fiduciary's actions do not have to cause a Plan to suffer financial loss for the fiduciary to have breached the prudent person rule. The mere fact that the fiduciary "lucks out" does not relieve the fiduciary of the responsibility of acting prudently and for the exclusive benefit of plan participants in the first place. A fiduciary's failure to consider all relevant aspects of a decision is sufficient to cause it to violate the prudence rule, even if it acts in the exclusive interest of Plan participants and avoids prohibited transactions. In one such case, the U.S. Court of Appeals for the Seventh Circuit's decision in Brock v. Robbins, the court, in finding the trustee liable, stated that the policies underlying the prudent person rule "prohibit creating an exception that immunizes . . . trustees who have acted imprudently, even though they may not have acted with sinister motives." The penalty in such a case can include removal of the plan fiduciary.

On the other hand, prudence also does not *require* the fiduciaries to show positive investment performance. Fiduciaries are not imprudent simply because the Plan lost money so long as the fiduciaries took all prudent steps in making and monitoring the Plan's investments in the first place. As the U.S. Court of Appeals for the Seventh Circuit said in another case, involving a substantial loss in a plan's assets due to the 500-point single day decline in the stock market in October 1987, "[t]he fiduciary duty of care requires prudence, not prescience."

The prudent person rule also extends to the Plan's operations. This requires the Plan's fiduciaries to periodically review the performance of all entities and people to whom they have allocated and delegated responsibility for the operation of the Plans and the investment of their assets to insure that they are carrying out their duties in a satisfactory manner. The Plan's administrative and benefit calculation systems should also be periodically reviewed to make sure the Plan is being operated in accordance with its terms and the requirements of all applicable laws. A periodic check should also be made to insure that all required government filings are being made in a timely manner and that all required disclosures are being given to the Plan's participants and beneficiaries.

In order to make sure that the Plan is operated in accordance with its terms, the fiduciary should keep appropriate records of all decisions made on matters of Plan interpretation (e.g. – eligibility for benefits) and administration. This will enable the Plan to operate in a consistent and non-discriminatory manner over time and will serve as a record should actions be challenged in the future.

If a fiduciary's interpretation of a Plan is challenged in court, the courts will generally uphold the fiduciary unless the actions are "arbitrary and capricious." However, in Firestone v. Bruch the Supreme Court refused to automatically uphold an administrator's decision. The Court required the Federal District Courts to substitute their own judgement for that of the plan fiduciary unless the plan document specifically gives the fiduciary the power to interpret the plan. According to a subsequent decision by the U.S. Court of Appeals for the Eleventh Circuit in Anderson v. Blue Cross/Blue Shield of Alabama, even if a plan gives the fiduciary the appropriate authority, the "arbitrary and capricious" standard will not be used where there is a conflict of interest. In such

cases, in addition to proving its interpretation was not arbitrary and capricious, the fiduciary would have to show that its interpretation of the Plan provisions was not tainted by self-interest and that it operated exclusively in the interests of Plan participants.

DIVERSIFICATION

Plan investments must be diversified "so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so." A Plan's investments should be diversified both as to type of investment (e.g. – mortgages, bonds, shares of stock, etc.); industry; geographical distribution where relevant (as in the case of investments in real estate or in mortgages on real property) and maturity. An investment in an insurance company contract or other pooled investment fund (e.g. – a mutual fund) is considered a diversified investment if the underlying assets of the insurance contract or pooled fund are diversified.

Thee is no fixed degree of investment concentration that would automatically violate diversification standards. Rather, each case depends on its own surrounding facts and circumstances, including the purposes of the Plan, the size of the Plan's assets and the general financial and economic conditions prevailing when the investment is made. Further, the relative safety of an investment will not save a Plan from a failure to diversify. In the case of a private sector plan, the U.S. Court of Appeals for the Eleventh Circuit held in GIW Industries, Inc. v. Trevor, Stewart, Burton & Jacobsen, Inc. that an investment of 70% of a plan's assets in long-term government securities violated ERISA's diversification rule. The plan's fiduciary failed to take the plan's cash flow needs into account when making the investment and the plan suffered a loss when he was forced to sell some of the bonds to raise cash.

DUTY TO INFORM

A Plan's fiduciaries have a duty to clearly and accurately inform employees of all relevant information regarding the Plan. According to the U.S. Court of Appeals for the District of Columbia Circuit in Eddy v. Colonial Life Insurance Company of America, this duty is the "core" of a fiduciary's responsibility. According to the court, the fiduciary's duty to disclose information is not discharged solely by complying with reporting and disclosure rules; rather, the fiduciary's duty "carries through in all of the fiduciary's dealings" with employees. The court stated that the information disclosed must do more than merely "not misinform," it must actually "inform" the employee – completely, correctly and in a manner understandable to the employee. This responsibility extends beyond giving an employee new and relevant information as it arises; it imposes an affirmative obligation to advise the employee of circumstances that could threaten his or her benefits.

The obligation to inform is triggered by an employee's request for information as well as by government reporting and disclosure requirements. Once an employee makes his or her situation clear to a member of the Employer's benefits administration staff, the Plans' fiduciaries have an obligation to make sure the employee is provided with all the information they know or should know to be relevant, even if the employee did not specifically request the information.

PROCEDURES

To help minimize their potential liability under fiduciary rules, fiduciaries should follow certain procedures in the performance of their duties.

Delegate Responsibilities
Under certain circumstances, the fiduciaries may delegate their fiduciary responsibilities, including their responsibilities with respect to Plan investments, to other individuals. These other individuals, in turn, become Plan fiduciaries to the extent of their delegated duties.

The right of the named fiduciaries to delegate their fiduciary responsibilities must be *specifically* set forth in statute or other documentation and must *expressly* provide a procedure for accomplishing the delegation. Absent these provisions, any delegation of fiduciary duty will be ineffective to relieve the named fiduciaries from responsibility or liability for the performance of the delegated duties.

If the delegation of the fiduciary responsibilities is effective, the fiduciaries will not be liable for the action or inaction of those to whom they have delegated the responsibilities if the fiduciary have acted prudently

- in choosing the person to whom they delegate their responsibilities;
- in implementing the procedures for delegating their responsibilities; and
- in continuing the delegation.

However, even if the fiduciaries are prudent in their delegation of their fiduciary duties, they may still be liable as co-fiduciaries if, for example, they permit the persons to whom they have delegated their responsibilities to breach fiduciary rules or if they knowingly cover up such a breach.

In implementing fiduciary rules in the private sector, the ERISA Conference Report describes the prudence requirement, as applied to continuing delegations of fiduciary responsibility, as follows:

> "In order to act prudently in retaining a person to whom duties have been delegated, it is expected that the fiduciary will periodically review this person's performance. Depending upon the circumstances, the requirement may be satisfied by formal periodic review (which may be by all the named fiduciaries who have participated in the delegation or by a specially designated review committee), or it may be met through day-to-day contact and evaluation, or in other appropriate ways. Since effective review requires that a person's services can be terminated, it may be necessary to enter into arrangements which a fiduciary can promptly terminate (within the limits of the circumstances)."

Ideally, the delegation should be in writing and should clearly state the duties being delegated, the limits on those duties, if any, the person or persons to whom they are being delegated and the standards to be used in carrying out the delegated duties. These standards should, of course,

include prudent person and exclusive benefit standards. The delegation of authority should be acknowledged and accepted by the person to whom the fiduciary duties are being delegated. The person to whom the responsibilities are delegated should also acknowledge that he or she is a fiduciary.

The documentation or procedures used to periodically review the performance of persons to whom fiduciary duties may have been delegated are very important. At a minimum, the minutes should contain an annual statement that the persons' performances have been reviewed and have been found to be satisfactory and in accordance with fiduciary standards.

As a practical matter, the Plan's fiduciaries must rely upon data and information provided by others which they cannot independently verify. A "plan fiduciary may rely on information, data, statistics or analyses furnished by persons performing the ministerial functions for the plan, provided that he has exercised prudence in the selection and retention of such persons. The plan fiduciary will be deemed to have acted prudently in such selection and retention if, in the exercise of ordinary care in such situation, he has no reason to doubt the competence, integrity or responsibility of such persons." Department of Labor Reg. § 2509.75-8.

Define Responsibilities

In order to limit the potential fiduciary liability of the fiduciaries other than the named fiduciaries, the responsibilities of such other fiduciaries should be clearly set out in a written charter issued by the appropriate party. The charter should describe the nature and extent of the individual's fiduciary responsibilities as clearly and explicitly as possible and how those responsibilities relate to the purposes of the Plans. It should also set out those powers, rights and responsibilities retained by others. Any requirements to report periodically to others should also be spelled out in the charter. The provisions of the charter should be reviewed periodically and updated as necessary.

The charter can serve as a basis for reviewing the ongoing performance of the fiduciaries acting under its authority.

Meetings

The fiduciaries should meet as frequently as is necessary for the diligent discharge of their responsibilities.

Records

Fiduciaries must act with the care, skill, prudence and diligence that the discharge of their responsibilities calls for. Minutes and records should be maintained explaining the basis of all decisions to be in a position to defend their actions if they should be questioned at any time in the future. The minutes of the meetings should include the following:

- The date, time and place of meeting;
- Who was present and whether a quorum existed;
- The subjects discussed at the meeting and the substance of the discussion, including an analysis of the facts, a description of any relevant circumstances prevailing at the time and a justification for any actions taken;

- The motions made at the meeting; and
- Whether the motion was adopted unanimously. If action was not unanimous, the names of those voting in favor of the motion, the names of those dissenting, and the reasons for the dissent should be recorded.

The Department of Labor, in DOL Reg. § 2509.75-5, FR-10, set forth guidelines for trustees' minutes. These guidelines, which are equally applicable to minutes for meetings of any fiduciaries, state that

> "trustees should take great care to document adequately all meetings where actions are taken with respect to management and control of the plan assets. Written minutes of all actions taken should be kept describing the action taken, and stating how each trustee voted on each matter. If. . . trustees object to a proposed action on the grounds of possible violations of the fiduciary responsibility provisions of the Act [ERISA], the trustees so objecting should insist that their objections and the responses to such objections be included in the record of the meeting."

Care should be taken to ensure the minutes are sufficiently detailed to enable the Plan's fiduciaries to use them to build a record to defend their actions if they are challenged in the future.

The minutes for each meeting should be prepared promptly after each meeting and distributed.

Appoint Investment Managers

Any decision on appointing, retaining or removing an investment manager should be made in accordance with fiduciary rules, including the requirement that the performance of any manager appointed be periodically reviewed. If the appropriate review procedures are followed and the fiduciaries' decisions are properly documented, including the reasons for those decisions, the fiduciaries should not be liable for the actions or inactions of the investment manager (except for any possible liability under ERISA's co-fiduciary rules).

To be eligible for appointment as an investment manager, the manager must be an investment advisor registered under the Investment Advisors Act of 1940, or a qualified bank or insurance company. The investment manager must accept his or her appointment and acknowledge his or her fiduciary status in writing. These acceptances should be maintained in the appropriate files.

A written agreement will be required between a fiduciary and each investment manager it appoints in which the manager acknowledges that it is a fiduciary with respect to the Plan. The agreement should also define the portion of the Plan's assets to be managed, establish a fee schedule, reserve the fiduciary's right to terminate the agreement at any time, and cover a number of miscellaneous topics such as brokerage transactions and the use of "soft dollars."

In order for a manager to properly discharge its responsibilities, the manager should operate within written guidelines defining the general investment policy the manager is to follow.

Establish Funding Policy And Method
ERISA requires Plans to have a funding policy. A funding policy and method is established to enable the fiduciaries to determine the Plan's short- and long-run financial needs and to communicate these needs to the appropriate people.

The funding policy should also include the determination of appropriate actuarial assumptions and methods and a funding target (relationship of Plan assets to Plan liabilities).

Adopt An Investment Policy
ERISA requires each of the Plans to have an investment policy coordinated with the funding policy.

Adopt A Proxy Voting Policy
ERISA requires each of the Plans to have a proxy voting policy.

The fiduciaries are responsible for voting all proxies received in connection with securities held unless they delegate that responsibility to any investment managers which may have been appointed.

Brokerage Commissions
Fiduciaries responsible for investing plan assets have a duty to use brokers who charge the lowest commissions for securities trades commensurate with the best execution of the trade. The one exception to the lowest commission rule (but not to the best execution rule) is the use of "soft dollar" arrangements under Section 28(e) of the Securities Exchange Act of 1934.

Section 28(e) provides that no person exercising investment discretion with respect to an account shall be deemed to have violated a fiduciary duty solely by reason of having caused the account to pay a broker a commission for a transaction in excess of the commission another broker would have charged if such person determined in good faith that the commission was reasonable in relation to the value of the brokerage and research services provided by the executing broker. The scope of Section 28(e) is, however, narrower than it seems. It does not eliminate the necessity for any of the following:

- Disclosure of the arrangements to the Plan;
- Necessity to deal fairly with the Plan; and
- Responsibility to obtain best execution.

Section 28(e) protects only persons who are exercising investment discretion with respect to an account. As a result, a direction by a fiduciary to an investment manager to use a particular broker generally will not fall within the scope of Section 28(e).

Administer the Plans

Satisfaction of fiduciary duties with regard to plan administration requires allocation of responsibility, development of procedures, careful documentation, consistency of action, and a review process. Major responsibilities include:

- Plan interpretation
- Maintenance of records
- Claims procedures including denial and appeal processes
- Payment of reasonable expenses necessary for the opinion of the Plan
- Required reporting and disclosure.

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