An Overview of Fiduciary Responsibilities

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What is a Fiduciary?

A fiduciary is defined as someone acting in a position of trust on behalf of, or for the benefit of, a third party. Fiduciary status is difficult to determine, and is based on *facts and circumstances*. In general, the issue is whether a person has control or influence over investment decisions. It is not uncommon for fiduciaries to be unaware of their status.

Duties & Responsibilities

Fiduciaries should acknowledge their responsibilities in writing.

Fiduciaries are responsible for the general management of the investments. If statutes and trust provisions permit, the fiduciary may delegate certain decisions to professional money managers, trustees (co-fiduciaries), and/or investment advisors and consultants. But even when decisions have been delegated to a professional, a fiduciary can never fully abdicate his or her responsibilities.

Included in the fiduciary's duties are:

- ⇒ Manage investment decisions in accordance with laws, regulations, and/or trust provisions?
- ⇒ Prudently diversify the portfolio to a specific risk/ return profile
- ⇒ Manage investment decisions in accordance with a written investment policy
- ⇒ Have investment decisions made by prudent experts, and document the due diligence process followed in selecting the prudent experts
- ⇒ Control and account for all investment-related expenses
- ⇒ Monitor the activities of selected prudent experts and other services vendors
- ⇒ Avoid conflicts of interests and prohibited transactions

Characteristics of a Successful Fiduciary

1. A sincere commitment and ability to develop a consensus formulation of goals and objectives.
2. A personal interest in understanding the basics of capital markets.
3. The discipline to develop long-term investment policies, and the patience to evaluate events calmly in the context of long-term trends.
4. An understanding of personal and organizational strengths and weaknesses to determine when delegation and outsourcing is more appropriate.
5. Effective management abilities. Distinguishing important tasks from unimportant task.

Frequency of Meetings

The frequency of meetings should be formally defined. In best business practices and case law it is suggested that reviews should be done at least quarterly and more frequently if warranted by events.

Meeting Minutes should be recorded and maintained when investment decisions are made. The minutes should include:

- ⇒ Time
- ⇒ Date
- ⇒ Meeting Type (Special, Scheduled)
- ⇒ List of Attendees
- ⇒ Matters Discussed
- ⇒ Materials Reviewed
- ⇒ Decision Made
- ⇒ Any other special notes

Adhering to applicable laws, trust documents and investment policy statements

The fiduciary should analyze and review all of the documents pertaining to the establishment and management of the investments. As in managing any business decision, the fiduciary has to set definitive goals and objectives that are consistent with the portfolio's current and future resources; the limits and constraints of applicable trust documents, laws and statutes; and, in the case of individual investors, the goals and objectives of the individual investor.

The intelligent and prudent management of investment decisions requires the fiduciary to maintain a rational, disciplined investment program. The astounding array of investment choices coupled with *market noise* from Wall Street understandably can result in financial paralysis from information overload. Fiduciaries clearly need a framework for making investment decisions that allows them to consider developing investment trends, and to thoughtfully navigate the possibilities.

Self-dealing, prohibited transactions, and/or conflicts of interest

The fundamental duty of the fiduciary is to manage investment decisions for the exclusive benefit of the client, retirement plan participant, and/or trust beneficiary. No one should receive a benefit simply because they are a friend, business associate, and/or relative of the fiduciary.

If a fiduciary even thinks he or she may have a conflict of interest - they probably do. The best advice is end it, or avoid it. It's that simple.

An excellent question every fiduciary should ask before deciding or voting on an investment issue is: *Who benefits most from this decision?* If the answer is any party

other than the client (in the case of an individual or family account), participant (in the case of a retirement plan), and/or the beneficiary (in the case of a personal trust), the likelihood is the fiduciary is about to breach his or her duties

Examples of common breaches

- ⇒ Using retirement plan assets to buy real estate for corporate expansion
- ⇒ Trading a client's account solely to generate additional commissions (also referred to as *churning* a client's account)
- ⇒ Using the assets of a public retirement plan to invest in local high-risk business ventures
- ⇒ Using the assets of a private trust to provide unsecured loans to related parties and/or entities of the trustee
- ⇒ Using a company retirement plan as collateral for a line of credit
- ⇒ Buying artwork and/or other collectibles with retirement plan assets, and putting the collectibles on display.

Avoiding contract and agreement provisions that conflict with fiduciary standards of care

A fiduciary is required to prudently manage investment decisions and should seek assistance from outside professionals, such as investment advisors/consultants and money managers, if the fiduciary lacks the requisite knowledge (assuming the trust documents permit the delegation of investment responsibilities).

The fiduciary should take reasonable steps to protect the portfolio from loses, and to avoid misunderstandings when hiring such professionals. Therefore, fiduciaries should reduce any agreement of substance to writing in order to define the scope of the parties' duties and responsibilities; to ensure that the portfolio is managed in accordance with the written documents that govern the investment strategy; and, to confirm that the parties have clear, mutual understandings of their roles and responsibilities.

Timing and distribution of cash flows, and payment of liabilities

One of the fundamental duties of every fiduciary is to ensure there are sufficient assets to pay bills and liabilities when they come due, and in the case of a foundation or endowment, to provide a specified level of support when it has been promised.

It is important that the fiduciary prepare a schedule of the portfolio's anticipated cash flows for the coming five-year period, so that the investment time horizon can be determined. The time horizon is defined as that point-in-time when more money is flowing out of the portfolio than is coming in from contributions and/or from portfolio growth. If the time horizon is less than five years, it is considered *short*, and if the time horizon is five years or more, it is considered *long*. A *short* time horizon typically is implemented with fixed income and cash, whereas a *long* investment time horizon can be prudently implemented across most asset classes.

The cash flow schedule also provides the fiduciary with information to more effectively rebalance a portfolio's asset allocation strategy. As an example, if a particular asset class is outside the range of the investment policy statement's strategic limit, one could use the cash flow information to effectively rebalance the portfolio.

Protection from theft and embezzlement

The fiduciary has the responsibility to safeguard entrusted assets, which includes keeping the assets within the purview of the U.S. judicial system. This provides a regulatory agency the ability to seize the assets if, in its determination, it is in the best interests of the beneficiaries and/or participants.

In addition, ERISA requires qualified retirement plans to maintain a surety bond to reimburse a plan for losses resulting from dishonest acts. Though not required for all other fiduciaries, it's a good industry practice to maintain similar coverage.

Exception: Investment advisors that are managing the personal assets of a high-net-worth client are not excluded from considering the establishment of offshore accounts. The presumption is that federal laws will continue to impose strict reporting and tracking requirements of foreign bank accounts and offshore trusts.

Identifying appropriate levels of risk

The term *risk* has different connotations, depending on the fiduciary's and/or the investor's frame of reference, circumstances, and objectives. Typically, the investment industry defines risk in terms of statistical measures, such as standard deviation. These statistical measures, however, often fail to adequately communicate the potential negative consequences an investment strategy can have on the fiduciary's, or the investor's, ability to meet investment objectives.

Simply stated, an investment strategy can fail by being too conservative or too aggressive. A fiduciary could adopt a very safe investment strategy by keeping a portfolio in cash, but then see the portfolio's purchasing power whither under inflation. Or, a fiduciary could implement a long-term growth strategy that overexposes a portfolio to equities, when a more conservative fixed income-strategy would have been sufficient to cover the identified goals and objectives.

Selecting an investment model that will meet the investment objectives

The fiduciary should determine whether trust documents, spending policies, and/or actuarial reports (for defined benefit retirement plans) establish a minimal investment return expectation or requirement. In all cases, the fiduciary should determine the *modeled*, or expected return a given investment strategy should produce. In this context, the term *model* means to replicate; to determine the probable returns of an investment strategy given current and historical information.

There is no requirement, or expectation, that the fiduciary forecast future returns. Rather, the fiduciary is required to state the presumptions that are being used to *model* the probable outcomes of a given investment strategy.

Investment's Time Horizon

It is important that the fiduciary prepare a schedule of the portfolio's anticipated cash flows so that the portfolio's investment time horizon can be identified. The portfolio's investment time horizon is defined as the point in time when disbursements in a given year exceed the sum of contributions, and increase in assets as a result of investment performance.

There is a hierarchy to the decisions that the fiduciary has to manage. The most important decision the fiduciary has to manage is the determination of the time horizon. Based on the time horizon, the fiduciary then can determine which asset classes can be appropriately considered; what the allocation should be between the selected asset classes; whether there should be an allocation made among sub-asset classes; and, finally, which money managers or mutual funds should be retained to manage each asset class.

Selecting Asset Classes that are consistent with the identified risk, return, and time horizon

The fiduciary's role is to choose the appropriate combination of asset classes that optimizes the identified risk and return objectives, consistent with the portfolio's time horizon. The fiduciary's choice of asset classes and their subsequent allocation will have more impact on the long-term performance of the investment strategy than all other decisions. The fiduciary's role is to choose the appropriate combination of assets that optimizes (or approximately optimizes) a return subject to a particular level of risk.

Number of Asset Classes

There is no formula the fiduciary can follow to determine the *best* number of asset classes - the *appropriate* number is determined by facts and circumstances. How many asset classes should be considered? Or in the case of participant-directed retirement plans, how many investment options should be offered? The answer is dependent upon the:

- ⇒ Size of the portfolio
- ⇒ Investment expertise of the investment decision makers
- ⇒ Ability of the decision makers to properly monitor the strategies and/or investment options
- ⇒ Sensitivity to investment expenses - more asset classes and/or options ordinarily will mean higher portfolio expenses. The additional costs should be evaluated in light of the *price* the fiduciary pays for being under-diversified.

Investment Policy Statement

The preparation and maintenance of the investment policy statement ("IPS") is one of the most critical functions of the fiduciary. The IPS should be viewed as the business plan and the essential management tool for directing and communicating the activities of the portfolio. It is a formal, long-range strategic plan that allows the fiduciary to coordinate the management of the investment program in a logical and consistent framework. All material investment facts, assumptions, and opinions should be included.

The fiduciary is required to manage investment decisions with a reasonable level of detail. By reducing that detail to writing, preparing a written IPS, the fiduciary can: (1) avoid unnecessary differences of opinion and the resulting conflicts; (2) minimize the possibility of missteps due to lack of clear guidelines; (3) establish a reasoned basis for measuring their compliance; and, (4) establish and communicate reasonable and clear expectations with participants, beneficiaries, and investors.

The IPS should have sufficient detail that a third party should be able to implement the investment strategy; be flexible enough that it can be implemented in a complex and dynamic financial environment; and yet not be so detailed it requires constant revisions and updates. The IPS should combine elements of planning and philosophy, and should address the management of each of the fiduciary standards of care. Addendums should be used to identify information that will change on a more frequent basis such as the names of board members, accountant, attorney, actuary, and money managers/ mutual funds; and the capital markets assumptions used to develop the plan's asset allocation.

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Defining duties and responsibilities

There are numerous parties involved in the investment process, and each should have their specific duties and requirements detailed in the IPS. This ensures continuity of the investment strategy when there is a change in fiduciaries; helps to prevent misunderstandings between parties; and helps to prevent omission of critical fiduciary functions. The IPS should include sections on:

⇒ The role of the investment committee
⇒ The role of the investment consultant (if one is retained)
⇒ The role of the custodian
⇒ The role of the separate account manager(s). [Not necessary for mutual funds since the investment strategy of the fund already is specified in the fund's prospectus.] The instructions for the money manager should include:

- Securities guidelines
- Responsibility to seek *best price and execution* on trading the securities
- Responsibility to account for *soft dollars*
- Responsibility to vote all proxies

Diversification and Rebalancing Guidelines

One of the challenges of writing a complete IPS is to create investment guidelines specific enough to clearly establish the parameters of the desired investment process, yet provide enough latitude so as not to create an oversight burden. This is particularly true when establishing the portfolio's asset allocation and rebalancing limits. The strategic asset allocation should be that specific mix of asset classes that meets the mutually agreed upon risk/return profile of the investor or investment committee.

The rebalancing limits define the points when a portfolio should be reallocated to bring it back in line with the established asset allocation target. The discipline of rebalancing, in essence, controls risk and forces the portfolio to move along a predetermined course. It takes gains from stellar performers or favored asset classes, and reallocates them to lagging styles.

While the legal requirement for diversification is clear, the need for rebalancing is not explicitly addressed. Nevertheless, rebalancing is an inherent concept of diversification, where the goal is to create a portfolio that balances appropriate levels of risk and return. That balance, once achieved, can only be maintained by periodically rebalancing the portfolio to maintain the appropriate diversification.

The process of setting an appropriate rebalancing limit is somewhat subjective. Ordinarily, rebalancing limits of plus-or-minus five percent should keep the parameters tight enough to maintain the risk/return profile of the strategy, yet require rebalancing only once or twice a year. When it is necessary to rebalance, the fiduciary should determine the cash flows over the next quarter to determine if the portfolio can be rebalanced with contributions or disbursements.

Due diligence criteria for selecting investment choices

A well-written IPS can serve to insulate the fiduciary from *market noise*, or in the context of this Practice, the temptation to chase the latest hot manager on Wall Street. By establishing specific asset allocation parameters and money manager (or mutual fund) selection criteria, it is much easier to determine whether a prospective manager fits into the general investment program.

There is no explicit requirement for fiduciaries to define due diligence criteria for the selection of money managers, however, it is implicit in other fiduciary requirements. As a practical matter, these provisions require a fiduciary to define the due diligence process and criteria for selecting investment options.

The fiduciary should investigate the qualities, characteristics, and merits of each money manager, and to identify the role each plays in the furtherance of the investment strategy. However, such an investigation and the related analysis cannot be conducted in a vacuum - it must be within the context of the needs of the investment strategy. Once the needs have been defined, and the general strategies developed, specific money managers should be chosen within the context of this strategy.

Monitoring criteria for investment options and vendors

The fiduciary duty to monitor the performance of investment managers and other service providers is inherent in the obligations of fiduciaries to act prudently in carrying out their duties. The investment management process triggers a number of reviews of the numerous parties involved in the investment process:

- **Monthly**, the custodial statement should be reviewed for accuracy and to determine whether hired money managers are continuing to seek best execution on trades
- **Periodically**, a performance report should be prepared indicating how well selected managers and/or funds are performing relative to the objectives set forth in the IPS, against their peers, and against an appropriate industry index.
- **Annually**, the IPS should be reviewed to determine whether there have been any material changes to the goals and objectives, or to the risk/return profile.

Specific performance criteria and objectives should be identified for each money manager and/or mutual fund. The one decision that is typically more difficult to make than Which manager or fund to hire? Is it time to fire the manager or fund? When performance criteria are agreed to in advance, the decision is easier to manage and to make.

Suggested Fields of Due Diligence
a. Regulatory oversight: Each investment option should be managed by: (a) a bank; (b) an insurance company; (c) a registered investment company (mutual fund); or, (d) a registered investment adviser.
b. Correlation to style or peer group: Each investment option should be highly correlated to the asset class being implemented.
c. Performance relative to a peer group: Each investment option's performance should be evaluated against the peer group's median manager return, for 1-, 3- and 5-year cumulative periods.
d. Performance relative to assumed risk: The investment option's risk-adjusted performance (Alpha and/or Sharpe Ratio) should be evaluated against the peer group's median manager's risk-adjusted performance.
e. Minimum track record: Each investment option should have sufficient history (suggested, at least three years) so that performance statistics can be properly calculated
f. Assets in the product: Each investment option should have sufficient assets so that the portfolio manager can properly trade the account. [Suggested threshold: Each investment option should have at least $75 million under management (for mutual funds - can include assets in related share classes).]
g. Holdings consistent with style: The underlying securities of each investment option should be consistent with the associated broad asset class. [Suggested threshold: At least 80% of the underlying securities should be consistent with the broad asset class. For example, a Large-Cap Growth product should not hold more than 20% in cash, fixed income and/or international securities.]
h. Expense ratios/fees: Each investment option's fees and expenses should be fair and reasonable. [Suggested threshold: Fees should not be in the bottom quartile (most expensive) of the peer group.]
i. Stability of the organization: There should be no perceived organizational problems. [Suggested threshold: The same portfolio management team should be in place for at least two years.]

Procedures for accounting and controlling costs

In order for the fiduciary to fulfill the general fiduciary obligation to manage investment decisions with the requisite level of care, skill, and prudence; and the specific obligation of the fiduciary to defray only reasonable and necessary expenses; the fiduciary must establish procedures for controlling and accounting for investment expenses.

In order to clearly define those procedures and to facilitate their implementation, they should be reduced to writing - most certainly as a matter of best practices and, most likely, as a factor in measuring the prudent conduct of the fiduciary.

Investment management costs and expenses can be broken down into four categories, and the IPS should contain instructions and procedures on how these fees and expenses will be accounted for and monitored. The fiduciary is cautioned that each can be obscured or moved from one category to another to create apparent savings.

The fiduciary should examine:

⇒ Money manager fees and/or the annual expenses of mutual funds.

⇒ Trading costs, including commission charges and execution expenses.

⇒ Custodial charges, including custodial fees, transaction charges, and cash management fees, consulting and administrative costs and fees.

⇒ In the case of defined contribution plans, demonstrate that 12b-1 fees subtransfer agency fees, and/or other revenue sharing arrangements have been appropriately applied to offset recordkeeping and other administrative costs of the plan.

Socially Responsible Investments

There is an increasing interest by fiduciaries to incorporate social, ethical, moral, and/or religious criteria into their investment strategy. The desire is to align investment decisions with the fiduciary's, investor's, and/or the beneficiary's core values. There are two terms that are used interchangeably by the industry; mission-based investing, and socially responsible investing (SRI).

However worthwhile or well-intended, fiduciary standards of care cannot be abrogated to accommodate the pursuit of a SRI strategy. As a general rule, any restriction on an investment program has the potential to reduce the portfolio's total return - itself a breach of fiduciary responsibility. The key to successfully incorporating a SRI strategy is for the fiduciary to demonstrate that investment results were not negatively impacted. It has become a generally accepted practice to permit the inclusion of a SRI strategy as a secondary screen to a normal (unrestricted) investment process. If there are equally attractive investment options, then social factors may be considered.

For fiduciaries guided by the UPIA, there are possibly three notable exceptions:

(1) The trust documents establishing the private trust, foundation, or endowment permit the use of SRI;

(2) A donor directs the use of a SRI Strategy; and,

(3) A reasonable person would deduce from the foundation's/endowment's mission that SRI would be adopted.

For defined contribution plans, in which investment decisions are participant-directed, a general investment option of the same peer group should be offered alongside each SRI investment option. As an example, if the investment committee chose to offer a SRI large-cap equity index fund, then a second large cap equity index fund that is not constrained by a SRI strategy also should be offered.

The Selection of Experts

Investment returns and risks are largely determined by asset allocation decisions. But what starts as strategy must be translated into reality with implementation. Fiduciary legislation does not expressly require the use of professional money managers and/or mutual funds. However, fiduciaries will be held to the same expert standard of care, and their activities and conduct will be measured against those of investment professionals. The prudent fiduciary should follow the time-proven maxim of doing what one does best and delegating (when trust documents permit) the rest to professionals.

Whether investment decisions are delegated to professionals (strongly encouraged) or retained by the fiduciary, the fiduciary should demonstrate that a due diligence process was followed in selecting each investment option.

As previously stated in this handbook, the primary role of the fiduciary is to manage the investment process. It is not to make investment decisions - it is not to attempt to make individual stock and bond picks. Let professional money managers build the portfolio. The fiduciary can be far more effective and efficient spending his or her time managing the managers. Therefore, for the purposes of this handbook, the emphasis is going to be on the due diligence process the fiduciary should develop in selecting the money managers.

Safe Harbor Provisions

When *safe harbor rules* are adopted, the fiduciary may be insulated from certain liabilities associated with the management of the portfolio's assets.

If investment decisions are being managed by a committee and/or by an investment advisor, then there are five generally recognized provisions to the *safe harbor rules:*

⇒ Use prudent experts to make the investment decisions
⇒ Demonstrate that the prudent expert was selected by following a due diligence process
⇒ Give the prudent expert discretion over the assets
⇒ Have the prudent expert acknowledge their co-fiduciary status
⇒ Monitor the activities of the prudent expert to ensure that the expert is performing the agreed upon tasks.

If investment decisions are participant-directed, as often is the case for defined contribution plans (401(k) plans), then there are **additional** provisions.

⇒ Plan participants must be notified that the plan sponsor intends to constitute a 404(c) plan
⇒ Participants must be provided at least three different investment options
⇒ Participants must receive sufficient education on the different investment options
⇒ Participants must be provided the opportunity to change their investment strategy/allocation with a frequency that is appropriate in light of market volatility.

Appropriate Investment Vehicles

The primary focus of this *Practice* is the implementation of the investment strategy with appropriate investment vehicles, specifically the proper use of mutual funds and separate account managers. A challenging question for most fiduciaries is: *At what point should there be a migration from mutual funds to separate account managers?* It is important for the fiduciary understand the pros and cons of both mutual funds and separate account managers, for no one implementation structure is *right* for all occasions.

Service Provider Due Diligence

Custodial selection is one of the most overlooked fiduciary functions. Most fiduciaries simply abdicate the decision to a vendor, advisor, or money manager. Yet, as with other prudent practices, there are a number of important decisions that need to be managed.

The role of the custodian is to:

(1) hold securities for safekeeping;

(2) report on holdings and transactions;

(3) collect interest and dividends; and,

(4) if required, effect trades.

At the retail level, the custodian typically is a brokerage firm. Most securities are held in street name, with the assets commingled with those of the brokerage firm. To protect the assets, brokerage firms are required to obtain insurance from the Securities Investor Protection Corp (SIPC).

Most institutional investors choose to use trust companies as custodians. The primary benefit is that the assets are held in a separate account, and are not commingled with other assets of the institution.

Performance Reviews

Once the optimal portfolio has been designed and the investment policy statement prepared and implemented, the final critical step is the ongoing monitoring and supervision of the investment process. The monitoring function extends beyond a strict examination of performance; by definition, monitoring occurs across all policy and procedural issues previously addressed in this handbook. The ongoing review, analysis, and monitoring of the money managers and/or mutual funds is just as important as the due diligence implemented during the manager selection process.

A long-term investment strategy requires alteration only when the underlying factors of the investment objectives change: tax status, risk tolerance, expected return, asset class preferences, and time horizon. These changes tend to be infrequent, if not rare, and reviews directed toward constantly reassessing existing policy tend to be counterproductive.

Monitoring includes an analysis of not only *what happened*, but also *why*? The analysis combines the elements of performance measurement - the science - with performance evaluation - the *art*. Performance measurement primarily is a technical accounting function that computes the return of the portfolio and component parts. Performance evaluation uses the information generated by performance measurement to determine what contributed to, or detracted from, the portfolio's return.

In keeping with the duty of prudence, a fiduciary appointing a money manager (or selecting a mutual fund) must determine the frequency of the reviews necessary, taking into account such factors as:

(1) the general economic conditions then prevailing;

(2) the size of the portfolio;

(3) the investment strategies employed;

(4) the investment objectives sought; and,

(5) the volatility of the investments selected.

The fiduciary has a continuing duty to exercise reasonable care, skill, and caution in monitoring the performance of investment decision makers, particularly when investment duties have been delegated to a money manager. The fiduciary's review of a money manager and/or mutual fund must be based on more than recent investment performance results, for all professional money managers will experience periods of poor performance. Fiduciaries also should not be lulled into rethinking their manager lineup simply because of the reported success of other managers.

In addition to the quantitative review of the money manager, periodic reviews of the qualitative performance and/or organizational changes to the investment manager should be made at reasonable intervals.

Best Practices

The fiduciary has a responsibility to control and account for investment expenses - that the expenses are prudent and are applied in the best interests of the investor, participant (in the case of a retirement plan), or beneficiary (in the case of a private trust, foundation, or endowment). The fiduciary, therefore, must monitor that:

⇒ *Best execution* practices are followed in securities transactions.

⇒ *Soft dollars* are expended only for brokerage, research, or other services for the benefit of the investment program, and are reasonable in relationship to the value of such services.

⇒ *Proxies are voted* in a manner most likely to preserve or enhance the value of the subject stock.

Investment Management Fees

The fiduciary responsibility in connection with the payment of fees is to determine:

(1) whether the fees can be paid from portfolio assets

(2) whether the fees are reasonable in light of the services to be provided to the plan. Accordingly, the fiduciary must negotiate all forms of compensation to be paid for investment management to ensure that the aggregate (and individual components) is reasonable compensation for the services rendered.

Money manager fees vary widely, depending on the asset class to be managed, the size of the account, and whether the funds are to be managed separately or placed into a commingled or mutual fund. Fees usually are charged in terms of basis points (100 basis points = 1.0%) and are applied to the market value of the portfolio at the end/beginning of a calendar quarter. Fees often decline significantly with increasing asset size.

Other Fees

The fiduciary has a duty to control and account for investment expenses. This requires the fiduciary to account for all dollars spent for services, whether those dollars are paid directly from the account or through *soft dollars*, 12b-1 fees, or

other fee-sharing arrangements.

In addition, the fiduciary has the responsibility to identify those parties that have been compensated for placing portfolio assets with a particular vendor to ensure that no party is unduly compensated. It is not uncommon for a broker to receive a commission stream in perpetuity on assets placed with a particular vendor. Though the broker should, ordinarily, be entitled to some form of compensation for the *introduction*, the fiduciary has a responsibility to apply a *reasonableness* test to the amount of compensation received by the broker.

In the case of a *bundled, wrap*, or *all-inclusive fee* investment product, there are basically four cost components. The fiduciary should investigate how the various service vendors associated with each component are compensated to ensure that no one vendor is receiving unreasonable compensation, and to compare the costs of the same services on an ala carte basis.