10 Things About Retirement Plans That Employers Should Know

By Ary Rosenbaum, Esq.

A plan sponsor must delegate much of their duties to retirement plan providers. That may include third party administrators (TPAs), financial advisors, and ERISA attorneys. Despite the fact that retirement plan sponsors delegate much of their role, they are still ultimately responsible for what happens to the plan in their role as plan fiduciaries. This is why it is important that retirement plan sponsors know basic concepts about retirement plans, so they can understand their role and their liability. This article is about 10 things that plan sponsor must know in order to understand their duties and the risk involved if they are derelict in their duties.

Fiduciary: With great power, comes great responsibility. As plan fiduciaries, plan sponsors have great responsibility and potential liability to the plan. In addition to the plan sponsor, individuals can serve as fiduciaries as well. Using discretion in administering and managing a retirement plan or controlling the plan's assets makes that person a plan fiduciary to the extent of that discretion or control. So, fiduciary status is based on the functions performed for the plan and not just based on a person's title. A plan's fiduciaries will ordinarily include the trustee, investment advisers, all individuals exercising discretion in the administration of the plan, all members of a plan's administrative committee (if it has such a committee), and those who select committee officials. Attorneys, accountants, and actuaries generally are not fiduciaries when acting solely in their professional capacities. The key to determining whether an individual or an entity is a fiduciary is whether they are exercising discretion or control over the plan. As the current definition of fiduciary stands now, registered investment advisors are fiduciaries, stock brokers are not. The Department of Labor (DOL) may propose a new definition that will include brokers as fiduciaries. Plan sponsors should understand that they are fiduciaries and must identify who else serves in that role for purposes of plan administration and as well as for issues of potential liability.

Fiduciary responsibility: Fiduciaries have important responsibilities and are subject to standards of conduct because they act on behalf of participants in a retirement plan and their beneficiaries. These responsibilities include: acting solely in the interest of plan participants; carrying out their duties prudently; following the plan documents; diversifying plan investments; and paying only reasonable plan expenses. Fiduciaries that do not follow these responsibilities will have breached their fiduciary duty and may be personally liable to restore any losses incurred by the plan, or to restore any profits made through improper use of the plan's assets resulting from their actions. What plan sponsors should really be aware of is that ultimately, the buck stops with them. That means that regardless of the incompetence of the providers they chose, they are ultimately responsible for any problems resulting in the administration of their plan. No ifs, ands, or buts. A plan sponsor can never fully eliminate all of their fiduciary responsibility, even if they hire an ERISA §3(38) fiduciary to assume the responsibility of managing the process of selecting and overseeing plan investments or an ERISA §3(16) administrator to handle the bulk of the work of the day to administration of the plan.

Section 408(b)(2) Regulation: The DOL regulation requires plan providers to reveal to the plan sponsor direct and indirect compensation that they receive from a plan. Plan sponsors need to be aware that receiving the disclosures is not enough; they must determine whether these fees being charges to administer the plan are reasonable. Paying excessive plan expenses is a breach of a fiduciary's duty of prudence. So the only way to actually determine whether costs are reasonable is to shop the plan around either using a retirement plan consultant, ERISA attorneys, or by contacting competing plan providers.

Section 404(a)(5) Regulations. Plan sponsors are not the only ones who get the costs of plan administration. Under this DOL regulation, participants get a disclosure of fees charges against their 401(k) account. The total cost in dollars being assessed to plan participants every quarter will be listed clearly on the participant's quarterly account statement. For plan sponsors unaware of the total costs associated with their retirement plan, this may result in participant complaints and questions about improved or lower cost retirement plan options. So not only finding the cost of a plan's administration an issue of fiduciary liability, it can also be a human resources disaster.

Defined Benefit Plan: A defined benefit plan promises a specified monthly benefit at retirement, which is based on a participant's salary, length of employment, and age, using an actuarial formula. While they have fallen out of favor among larger employers because of governmental regulation and the proliferation of 401(k) plans, they are still highly attractive for sole proprietors and small businesses.

Cash Balance Plan: A cash balance plan is a defined benefit plan (they are not hybrid plans as some may claim) that defines the benefit in terms that are more characteristic of a defined contribution plan. In other words, a cash balance plan defines the promised benefit in terms of a stated account balance (which is actually hypothetical). Working with a 401(k) plan, cash balance plans are more flexible in plan design than traditional defined benefit plans and may be a great fit for professional service firms as well as any company willing to pay 5% to 7% for their staff, which will lead to larger contributions for highly compensated employees.

Defined Contribution Plan: Unlike a defined benefit plan, a defined contribution plan does not promise a specified retirement benefit. It offers a defined contribution allocation formula which allocates contributions to a participant's account, where the participant will bear the gains and losses from the investments in their account (whether or not they direct their investment). Profit sharing plans are a type of a defined contribution plan. A 401(k) plan is a profit sharing plan with a cash or deferred arrangement. No profits are needed to make a profit sharing contribution.

Form 5500. The annual reporting return to be filed electronically for all plans subjects to ERISA. Forms 5500 must generally be filed by the last day of the seventh month following the end of the plan year, unless an extension has been granted (July 31 for a calendar year plan). Retirement plans with more than 100 participants (except for those that fall under the 80/120 rules) must also include an audit performed by an independent auditing/accounting firm. Failure to file a Form 5500 can result in huge penalties unless the plan sponsor corrects the problem thorough the DOL's voluntary compliance program.

ERISA §404(c): The provision in ERISA that limits a plan sponsor's liability in a participant directed investment retirement plan. Many plan sponsors assume that offering plan participants some mutual funds to invest in and Morningstar profiles exempted plan sponsors from liability. Section 404(c) protection requires a process. Plan sponsors need an investment policy statement (IPS) which details why particular plan investments were selected. They must review and replace investment options with their financial advisors at least annually based on the terms of the IPS and meaningful education must be given to participants. All decision making in this §404(c) process should be documented.

The myth of free administration: There is no such thing as a free lunch of free 401(k) administration. Whether a plan sponsor is using an insurance company platform or large enough to deal directly with mutual fund companies, they are paying for administration whether they believe or not. Whether the administration fees are considered "free" or low, the provider makes up the low cost through wrap fees (hidden fees added to mutual funds by insurance providers) or 12b1/revenue sharing fees (that mutual fund companies wouldn't have to share in a bundled environment.

These are just some of the basic concepts of retirement plan that plan sponsors need to understand. If you have any questions, ask your local TPA or contacts yours truly. I never charge a plan sponsor for a phone call because helping plan sponsors is one important way in improving retirement plans.

The Rosenbaum Law Firm P.C.

The Rosenbaum Law Firm P.C.
734 Franklin Avenue, Suite 302
Garden City, New York 11530
(516) 594-1557

http://www.therosenbaumlawfirm.com
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