Errors that Retirement Plan Sponsors Should Avoid But Do Anyway

By Ary Rosenbaum, Esq.

The Surgeon General's report on smoking was released almost 50 years ago and people still smoke cigarettes. We know the effects of cholesterol, heart disease, and the calorie count at many fast food restaurants, yet their sales are still well. Alcohol consumption (which does have some medical benefits in moderation) has lead to impaired driving and abuse, yet liquor establishments are still in business. Thanks to advances in medical research, we know what can harm us. Even with that knowledge, we still do it anyway. The same can be said about common mistakes that plan sponsors commit in their role as plan fiduciaries, errors that increase their liability, but they still do it anyway. So this article is about common plan sponsor errors that plan sponsors continue to do even if they understand the error of their ways.

Not hiring a Financial Advisor

There are a lot of plan sponsors out there that have a negative view of financial advisors because they think they can do it all themselves. They reason that since they can manage their own finances, they can do the same for the plan. The problem is that the role of a retirement plan financial advisor is not just picking investments. Heck, I have been investing on my own since I started my career, but I know I will need to hire a retirement plan financial advisor when I have an employee join my 401(k) plan because I don't know how to draft an investment policy statement (IPS) or provide education to plan participants. We can all do things on our own, like home improvement or self-medication, but we know that won't work when that is going to start to involve an independent third party. Aside from purchasing fiduciary liability protection and hiring a competent third party administrator (TPA), there is no better protection for liability than the hiring of a competent financial advisor.

Not caring that Participants are footing the bill

Did you ever invite someone out to dinner and you noticed that your guest is only picking the most expensive items on the menu, only because you are footing the bill? Well if you did, then the harm is that you have to shell out for an expensive meal and you've lost a future dinner companion. When it comes to retirement plans, this may involve liability. When it comes to most retirement plans (especially participant directed 401(k) plans), participants are actually paying the plan expenses. The problem? A plan sponsor has a fiduciary duty to pay reasonable expenses, especially when the participant is footing the bill. A fiduciary duty is the highest duty, known to equity and law. So while a plan sponsor can certainly show no care about how much they pay for plan expenses from their own pocket, they have to be vigilant about fees if they are having their participants pay the "freight" of running the plan. Participants have sued too many plan sponsors because the fees the participants paying were not reasonable. So plan sponsors should care how much fees are being charged to the plan and being paid by participants.

Not Reviewing Plan Providers for cost and competency

We all our creatures of comfort, we visit the same establishments and keep the same service providers we always use because there is that comfort level and the fear of the unknown of hiring someone else. While there is nothing wrong with visiting the same pizza place again and again, plan sponsors don't have that leeway. Since plan sponsors have a fiduciary duty to the plan, plan sponsors need to review their plan providers and ensure that the fees they are paying are reasonable. Plan sponsors usually have no idea if their plan providers are doing their job correctly, until the errors are discovered later down the line. This line usually happens when the plan sponsors changed the provider and the new provider tells the plan sponsor of a discovered "surprise", that is more of a compliance nightmare. Since plan sponsors are on the hook for the work of their plan providers, it makes sense once in a while to have their providers reviewed by an independent consultant or an ERISA attorney that is reasonable in their fees (cough, cough). Now that plan sponsors get a review of the schedule of fees being charged by their plan providers, plan sponsors now have no excuse not to compare the services and fees they are currently receiving to what is actually out there. They can make these comparisons by hiring a consultant, a cost effective ERISA attorney (cough, cough) or doing the job on their own.

Not reviewing their Plans on an annual basis

Whether it's their plan providers, their plan document, their plan's administration, and their plan design, plan sponsors need to have their plans reviewed on an annual basis. The reason is not only to ensure proper compliance with the requirements of the Internal Revenue Code and ERISA, it is also to make sure that the plan still meets their needs. A plan type or plan design may make sense when there is 2-3employees, but may no longer be cost effective when there are 100 employees like a defined benefit plan or a 401(k) plan without a safe harbor plan design. In addition, when a plan increases in asset size, the TPA or bundled provider may no longer be cost effective. Inefficient plans may be costly or not maximizing retirement savings for their highly compensated employees. So it's incumbent on plan sponsors to find out where their plan still works and where there are signs for improvement.

Having too much loyalty to current plan providers

Loyalty is an admirable trait to a degree. There is nothing wrong with wanting to use the same provider as long as there is a process to review their work and their fees. There is an issue when that loyalty is more idolatry than actual loyalty. Using a plan provider should not be confused with marriage, so speaking to another provider to compare services isn't a form of adultery, but good form as a plan fiduciary. Loyalty is a two way street and often you find that your loyalty to an employer or provider isn't met with the same duty of honor and loyalty on the other side. Plan sponsors may be loyal to a plan provider that isn't competent and/or charging an excess fee, so the need for review is paramount in delineating which providers they can have some degree of loyalty and which need to hit the road.

Not admitting their limitations

As Clint Eastwood said in the Dirty Harry classic, Magnum Force, "A good man always knows his limitations." When it comes to retirement plans, a good plan sponsor always knows their limitations. So while a good first step is hiring plan providers to delegate the bulk of their work, the fiduciary liability of the plan still sticks with the plan sponsor. So in order to manage that liability risk, plan sponsors should take the steps to minimize that risk since they can never fully eliminate it. Plan sponsors need to look in the mirror and determine what type of risk they actually handle and minimize the risk that they clearly do not have the sophistication to control. So that at least means the purchase of fiduciary liability insurance for plan fiduciaries to protect against any legal claims that plan participants my assert through litigation In addition, plan sponsors may want to consider hiring plan providers that will take on more of the risk and more of the liability, namely those willing to serve in a fiduciary capacity. A TPA offering an ERISA §3(16) service will serve as the ERISA defined administrator. A financial advisor taking on a §3(21) fiduciary role if offering to take on more of the liability that an advisor that is either not serving as a fiduciary or offering a vague co-fiduciary role. A financial advisor offering an ERISA §3(38) fiduciary service is willing to take on the role of an

ERISA defined investment manager and assume the liability of handling the fiduciary process (note hiring any fiduciary is still a fiduciary function exercised by the plan sponsor). So it's incumbent on the plan sponsor to determine how much help they need and when they need it. Clearly a ten person company without a human resources department is likely to need more help than a plan sponsor with thousands of participants where the main plan contact is a certified employee benefit specialist (CEBS). There is nothing wrong with a plan sponsor asking for help, there is a potential breach of fiduciary duty when it's clear they need it and don't seek it.

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
Follow us on Twitter @rosenbaumlaw