How Employers Can Avoid Turning Their Retirement Plan Into An HR Disaster

By Ary Rosenbaum, Esq.

When it comes to recruiting and retaining employees, salary isn't enough. Employees also seek benefits, which can be treated as tax-free compensation such as employer-provided health insurance and tuition assistance. One important employee benefit that is often used as a recruiting and retaining tool is an employer-sponsored retirement plan. Too often plan sponsors forget that the purpose of setting up a retirement plan is to help an employee achieve tax-deferred savings for retirement. While a retirement plan is an important employee benefit, the flip side is that a poorly run retirement plan can expose the plan sponsor to liability and become a human resources disaster. So this article is about how plan sponsors can avoid having their retirement plans become human relations disasters.

Always Put the Participants First: Under the Employee Retirement Income Security Act of 1974 (ERISA), a retirement plan is established for the exclusive benefit of plan participants. So when it comes to hiring retirement plan providers for their plan, it's not a good idea for plan sponsors to operate their plan like it's a patronage mill. Selecting plan providers should be a process and not an opportunity to reward someone's relative or the bank that extended them a line of credit by making them plan providers. Plan sponsors should never lose sight of the fact that plan participants were the reason for setting up the plan in the first place and that a retirement plan is an effective recruitment and retention tool. If plan sponsors remember this fact, they have won half the battle in their job as plan fiduciaries.

Surround Themselves With the Right Team: When it comes to athletes, you are only as good as your team. The same can be said of a retirement plan sponsor and the team of plan providers they have selected. Clearly, retirement plans with competent and professional third party administrators (TPAs), financial advisors, and ERISA attorneys get sued less often that those that hire incompetent plan providers. Picking the right team is absolutely essential.

Keep the Lines of Communications Open: When dealing with plans that are subject to ERISA and the Internal Revenue Code, there are certain notice requirements where participants must be informed. The notices may deal with safe harbor contributions, plan termination, and plan amendments. In addition, all participants should receive a copy of the summary plan description and the summary annual report, as well as their account statements. In life, the dissemination of information can help avoid issues of miscommunication. When it comes to managing employee relations, miscommunication can lead to liability. As plan fiduciaries, plan sponsors need to ensure that participants get all of their required disclosures to avoid any sanction by the Department of Labor (DOL) and/or Internal Revenue Service.

Give Employer Contributions: If we lived in an ideal world, an employer would have enough money to provide employer contributions to their employees in a retirement plan. Of course, we don't live in an ideal world and an employer has to operate within their means. Employer contributions to an employer sponsored retirement plan are an excellent employee benefit, so an employer that can afford to make them should consider doing so.

Make Plan Provisions Participant-Friendly: When developing a retirement plan, plan sponsors should consider plan provisions that are participant friendly. While these participant friendly provisions may be costly to plan sponsors some increased plan expenses and contributions such as having eligibility requirements of less than a year, a more favorable vesting schedules, as well as offering a loan and hardship provision (if the plan is a 401(k) plan). Provisions that are favorable to plan participants will help increase plan participation,

Concentrate on Plan Expenses: As plan fiduciaries, plan sponsors have a duty to make sure that the fees that the plan is paying are reasonable. Reasonableness is a vague term, but plan sponsors should make sure that the fees they are paying are reasonable (compared as what is available in the marketplace) for the services provided. In addition, plan participants get a disclosure of fees being charged to their plan. So despite the fact that it was always their job, plan sponsors now have to be more vigilant in making sure that the fees that their plan is paying are reasonable. As soon as the plan sponsors get their fee disclosure from their plan providers, they should benchmark their fees to see whether they are reasonable. That means they should shop the plan to other providers or hire a pension consultant or ERISA attorney tor use a service to review their schedule of fees. When it comes to lawsuits by participants against plan sponsors, one of the major reasons for litigation has been about excessive fees. Plan sponsors and plan providers have been sued over excess fees. Some plan sponsors have even been sued for offering mutual fund shares under the plan on a retail share class when a less expensive, institutional share class was available. So plan sponsors have been sued for paying retail when wholesale pricing was available. Plan sponsors need to concentrate on plan expenses to avoid liability. That doesn't mean they should pick the cheapest provider, they just need to make sure that the fees that they are paying are reasonable for the services provided.

Have a Financial Advisor Help Manage the Fiduciary Process: It is quite amazing to realize that so many retirement plans out there don't have a financial advisor to help manage the fiduciary process of selecting plan investments whether the plan's investments are directed by the participant or trustee. The fiduciary process is about developing an investment policy statement (IPS) that will dictate how plan investments are made and replaced, as well as offering education to participants if the plan's investments are participant-directed. In addition, all decisions regarding plan investments should be memorialized. Plan sponsors need to be aware that, just because plan participants direct their own investments, they will only avoid liability under ERISA §404(c) by offering participant direction is by managing the fiduciary process effectively. The only way to do that is by hiring a financial advisor with the background in retirement plans to do that. Thanks to places like Home Depot, we have a do it yourself attitude. However, plan sponsors can't offer retirement plan financial advice by themselves. Too many plan sponsors have been sued for breach of fiduciary duty just because they have no IPS or they haven't reviewed their plan investments on an annual or semi-annual basis. So plan sponsors need to hire a financial advisor that will help manage the fiduciary process and avoid the financial advisor who shows up once in a while and doesn't understand his or her role.

Provide Investment Education and/or Advice to Participants: When it comes to retirement plans that have plan investments directed by the participants, one of the complaints is that participants are ill-equipped to handle it. That is a problem since plan sponsors offer participant direction since they are trying to limit their liability under ERISA §404(c). So while ERISA §404(c) doesn't require plan sponsors to offer investment education and/or advice, DOL regulations don't allow plan sponsors the right to sit around and do nothing. Under the DOL regulations issued under ERISA §404(c), in order for plan participants to exercise control for purposes of making it a participant-directed plan, the fiduciaries must provide sufficient information to participants so that they can make informed decisions charged to the participant's account (e.g., commissions, sales load, deferred sales charges, and redemption or exchange fees). I had to tell my human resources director at my old law firm that handing out Morningstar profiles isn't sufficient to avoid liability. In order to take full advantage of the liability protection under ERISA §404(c), plan sponsors should consider offering investment education and/or advice to participants. Better educated participants will lead to better investment returns for them, which would surely help plan sponsors mitigate their liability because plan participants who make money in their 401(k) accounts rarely sue.

Managing a staff of employees is hard work and some missteps can create unnecessary headaches and even liability for employers. The same can be said about a retirement plan. The purpose of a retirement plan is to recruit and retain employees. If a plan sponsor ignores their duty as a plan fiduciary, the retirement plan can be a human relations disaster, diminish employee morale and create expose the taxpayer to liability.

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