The Value of a Good Retirement Plan Financial Advvisor

By Ary Rosenbaum, Esq.

Home Depot sparked the do it yourself business when it came to home improvement. This do it yourself business has spread to investing. In the old days, you needed a broker and you paid high fixed fees for trading. Thanks to deregulation, the explosion of mutual funds, and internet discount brokers, laymen have been able to partake in handling their own investments. In the do it yourself world of investing, financial advisors are seen as useful as travel agents. While these do it yourself investors don't understand the utility of financial advisors for their own portfolio, financial advisors serve an important purpose in the administration of retirement plans. A good financial advisor will offer education to plan sponsors, trustees, and (if the plan is participant directed) plan participants. The good financial advisor will help minimize the plan sponsor's fiduciary liability and improve the retirement savings under the Plan at a reasonable fee.

An employer who sponsors a retirement plan and the plan's individual trustees are fiduciaries. 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 the duty to act prudently and to diversify plan investments. The duty to act prudently is one of a fiduciary's central responsibilities under ERISA. It requires expertise in a variety of areas, such as investments. Lacking that expertise, a fiduciary will want to hire someone with that professional knowledge to carry out the investment decisions and other functions. Prudence focuses on the process for making fiduciary decisions. Unless a plan sponsor and the trustees have a background and education in finance, they need to hire a financial advisor to advise them, regardless of how the investments are made under the Plan.

Financial advisors serve a paramount importance in retirement plans where the investments are trustee directed. Since all the assets are under the trustees' direction, any gain or loss is on them as there is no provision under ERISA to limit their liability. The good financial advisor will develop an investment policy statement (IPS) with the trustees, as well as a strategy to execute the parameters set forth by the IPS. The financial advisor will also advise the plan sponsor and trustees on changes in the marketplace and advise them on any tactical investing changes that have to be made. The perfect example was a union plan that I handled for a number of years. The financial advisor showed up at quarterly trustee meetings and would give a presentation of changes in the financial world, changes in the plan's investments, as well as any suggestions on what changes that the plan's trustees should make. The financial advisor also constantly reviewed the terms of the IPS and would make changes with the trustees' approval to allow for other investments that the financial advisor thought was worthy. While the financial advisor's track record for the plan was impeccable, ERISA has no concern about performance; ERISA cares only about process and whether the plan fiduciaries completed that process. So rate of return isn't nearly as important as fiduciary review meetings, implementation of an IPS, and documentation of all decisions made by the plan fiduciaries.

For participant directed plans, there is a misnomer as to the plan fiduciaries' role and liability. Participant directed plans that adhere to ERISA Section 404(c) limit the fiduciaries' liability as the participants borne the liability for the gain and loss of their account balance. The problem is that most plan fiduciaries don't understand that ERISA 404(c) is not a get out of jail free card or as I call it, a suicide pact. ERISA 404(c) also requires that the plan fiduciaries follow a process and only if they complete that process will they achieve limited liability for participants' losses through self direction. The ERISA 404(c) process requires participants to be given the opportunity to choose from a broad range of investment alternatives, there must be at least three different investment options so that employees can diversify investments within an investment category. In addition, participants must be given sufficient information to make informed decisions about the options offered under the plan. Participants also must be allowed to give investment instructions at least once a quarter, and perhaps more often if the investment option is volatile. The investment alternatives must be selected based on criteria set forth in the IPS and reviewed at least on a semi-annual basis to determine whether they still comply with the IPS.

To illustrate this point and plan fiduciaries' ignorance of ERISA 404(c) liability,

I was working at a semi-prestigious Long Island law firm and the firm's human resources director asked me to talk to her about the firm's 401(k) plan soon after I joined the firm. The HR director also served as one of the plan's trustees and she asked for my guidance. The HR director handed me a lineup of the plan's mutual funds for participant direction. While I am not a financial advisor, I realized the fund lineup boasted of some funds that were top notch funds, 10 years earlier, I asked the HR director who selected the funds and she informed that an ERISA partner who left the firm and was a former trustee picked those funds about 10 years earlier. The plan had no financial advisor, the plan had no investment policy statement, and the funds hadn't been reviewed in about 10 years. To top it off, I asked the HR director what type of education or information that is distributed to plan participants. The HR director told me that there was no enrollment/investment education meetings for participants and the only information that participants received were Morningstar mutual fund profiles. Needless to say, I was very frank and told the HR director that not only was the law firm breaching their fiduciary liability but in her position as trustee, she was doing the same and her liability could be personal liability. Within months, we had a financial advisor and enrollment/education meetings for participants. The lesson to be learned here is that if a law firm with ERISA partners can't figure out the value of a financial advisor, why should any other plan sponsor?

Despite my talk that retirement plans need a good financial advisor to enhance their retirement savings and limit their liability, I am still amazed how many retirement plan sponsors have no financial advisors. This usually occurs when the plan is being administered by a mutual fund company or by a payroll provider. For the plans being administered by a mutual fund company, simply using that company's mutual funds on the fund lineup won't substitute the role of a financial advisor in limiting liability or providing participant education. Payroll provider TPA administered plans with no financial advisors are even worse because these payroll providers do offer mutual fund lineups to plan sponsors, but they clearly state that what they offer is not investment advice and they do not act in any fiduciary capacity. So what they offer the plan sponsor are mutual fund lineups and nothing more. So while plan sponsors think they are receiving some sort of fiduciary support from their payroll provider, courts have been telling plan sponsors differently, that payroll provider TPAs are not fiduciaries for the plans they administer. Why should plan sponsors rely on what I call "fake advisors" when they can have the real thing?

While many retirement plans have financial advisors, many of these financial advisors are what I call "milk carton advisors",

meaning that the plan sponsors hasn't seen their advisor in quite some time that they might be missing and should be placed on a milk carton. So hiring a financial advisor for your retirement plan isn't enough, making sure that the advisor that they hire partake in and manage the fiduciary process. Names, credentials, and returns are nice, but the most important aspect that a financial advisor is needed for is following the fiduciary process of selecting funds, meeting with the fiduciaries on a continuing basis, the drafting of the IPS, and providing education to participants when the plan is participant directed. The best advisor don't just help in the fiduciary process, they go above and beyond their role and serve as an ombudsman between the plan sponsor and other plan providers to make sure that the plan administration is smooth and that the plan maintains its qualification under the Internal Revenue Code.

How to tell the good financial advisors from the so-so and not so good advisors? Look for financial advisors who understand retirement plans, handle retirement plans on a consistent basis, someone who is independent in the sense that the only investment product they push are the best performing investments products. Choose a financial advisor that is independent from your TPA because they won't pick funds, predominately based on how much revenue sharing they will kick back to the TPA. Choose a financial advisor because they will assist your role as a fiduciary which will limit your liability, so hiring a financial advisor only because he or she is someone's cousin won't suffice. Nepotism is a nice concept for those that benefit from it, but it will only create conflicts of interests, increased fiduciary liability, and a possible claim that the relationship with a related advisor is a prohibited transaction. Charity begins at home, but pick another charity than your retirement plan,

Thanks to the internet and CNBC, many people think that they are financial experts. While they invest their own money and do well handling that on their own, they need a financial advisor for their retirement plan the moment they hire an employee that is not related to them. Financial advisor offer a service to retirement plans that can't be duplicated by any other service provider. They have the background and training to draft an IPS, develop an investment lineup, provide education to participants, meet with the plan's fiduciaries, and document what transpired in those fiduciary review meetings.

Next to purchasing an ERISA bond and fiduciary liability insurance, the best way to limit liability is to hire a financial advisor that will become your partner in managing the investment side of that retirement plan. So financial advisors are not the travel agents of the financial world, they serve a purpose that cannot be imitated.

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