The Top 10 Major Misconceptions Plan Sponsors Have About Their Retirement Plans

By Ary Rosenbaum, Esq.

Retirement plans can be an effective means for employee retention and tax savings. However if not operated properly, a retirement plan can inadvertently expose the employer to liability from unhappy plan participants and the federal government (namely the Department of Labor (DOL) and the Internal Revenue Service (IRS)). While most employers try to do right by their employees with their retirement plans, the employer's lack of expertise and sophistication in the nuances of retirement plans are often taken advantage of by unscrupulous financial advisors, attorneys, accountants, and third party administration (TPA) firms. Since employers delegate plan decisions to these unscrupulous professionals, employers rely on major misconceptions about retirement plans that unwittingly exposes them to potential liability.

While the list of major misconceptions about retirement plans is just a portion of the wrong advice that plan sponsors rely on, this list represents many misconceptions that I have seen when I have had meetings with potential clients. So without further adieu, here is my list:

10. We can handle this plan all by ourselves.

The rules of retirement plans are quite complex and there are many plan professionals (whether they are brokers, ERISA attorneys, Certified Public Accountants, and TPA firms) who get these rules wrong too. So why does an Employer think they can do plan investments, plan documents, and plan administration all by themselves? Unless that Employer is in the retirement plan business, they can't. Working with retirement plans is complex and requires expertise; do not try this at home or at your office.

9. We don't need an ERISA bond or fiduciary liability insurance.

One of the biggest misconceptions that retirement plan professionals had was on the Department of Labor (DOL) requirement that a plan sponsor purchase an ERISA bond to protect plan assets, many thought it was merely guidance. Guidance from the DOL now indicates that such bonding requirement is mandatory. In light of investment professionals using plan assets for a ponzi scheme, an ERISA bond is an inexpensive way to protect plan assets. Employers should also purchase fiduciary liability insurance to protect the Employer and plan trustees from possible liability (personal liability for trustees) from plan participants and other aggrieved entities.

8. That professional firm has to be good — my TPA recommended them.

With any decision to hire an outside firm to do work for your business or for your personal needs, good referrals are always important. However, when a plan sponsor receives a referral from a TPA for another retirement plan professional firm, the plan sponsor still should investigate the referred firm as well as the relationship between that firm and the TPA. The plan sponsor should also ensure that these referred firms derive a substantial portion of their business from retirement plans handled by other TPA firms. This will ensure that the professional firm is independent from the TPA and not it's captive. From time to time, I have seen ERISA attorneys and especially certified public accounting firms who perform plan audit work (for retirement plans with 100+ participants that require them) have a non-independent relationship with the TPA. This may be as a result of an ERISA attorney splitting a fee with the TPA (which is against state bar rules) or a CPA firm acting as a shell (which allows the TPA to self-audit the plans they administer). Good referrals are important; a TPA that offers more than one firm to refer per professional service is more likely to offer honest referrals than a TPA who only refers one firm per professional service.

7. We don't have to worry about plan design.

While Employers don't have to be experts in retirement plans, they should understand the basic plan design of their retirement plan. Whether the plan is a defined benefit plan or a 401(k) plan, the Employer should understand the basic plan design for eligibility and plan contributions, any required Employer contributions, as well as any further contributions that may be needed for a failed discrimination test. Employers should also understand whether the plan design still fits their firm's needs. I have a client that did not understand that the liability as a defined benefit plan sponsor mushroomed when the Firm doubled in size. I am not suggesting that Employers become experts in the Internal Revenue Code and ERISA, I just suggest that Employers ask their retirement plan professionals about their plan design to see if it still fits their business and retirement planning needs.

6. My broker/advisor picked those funds years ago. They are still good.

As we know, things change. Ten years ago, no one could foresee the advances in technology as well as some of the major political and international issues we are facing today. So why do plan sponsors still think they can rely on plan investments they selected so many years ago? Investment companies change, investment managers change, and investing styles change. An Employer who sponsors a retirement plan should ensure that their financial advisor is constantly monitoring their plan investments to ensure that they are still sound. If the Employer hasn't seen their financial advisor in a few years, perhaps they should find one that will ensure that the investment vehicles are proper and consistent with the plan's investment policy statement (IPS). In addition, many plan sponsors don't have an IPS and they should have one because it will help them minimize potential liability. Recent DOL audits on retirement plans have had DOL agents asking for the IPS from plan sponsors.

5. Expense ratios — I don't have to worry about that.

The retirement plan industry is riddled with hidden fees that an Employer who sponsors a retirement plan is unaware of. One fee that an Employer can easily be made aware of is the expense ratio of mutual funds offered under the Plan. An Employer should review the prospectus and also determine the actual share class that the Plan has. Mutual fund companies play alphabet soup and assign letters to different shares of fund classes. Some share classes are more expensive and some share classes are inappropriate, depending on the plan's size. Plan sponsors have been held liable for just having more expensive share classes in their Plan when less expensive classes of the very same mutual fund were available.

4**. I only want low cost funds.**

While Employers should concentrate on learning the expense ratios of their plan's investments, these plan sponsors should not entirely focus on providing low fee plan investments. The largest reason for the loss in retirement savings over the past couple of years is poor performance. The Employer should review the plan investments and determine how these investments compare to their respective investment benchmark over a one year, 3 year, or 5 year period. If your financial advisor has packed your investment fund lineup with dogs, perhaps it's time to tell them to take those dogs out for a walk and never come back.

3. That broker is good. He's my cousin.

Employers sometimes use the relative of one of its principals as the plan's broker or RIA. While that may make for good talk at family reunions, it may not make for good talk at employee education/ plan enrollment meetings. While using a family member is not illegal per se, it does give the look of impropriety. While the boss' cousin has to eat too, the Employer has to have a process in selecting a financial advisor, simply feeding a relative as your advisor is not enough.

2. The plan investments are directed by the employees — we're free as a bird.

Employers who offer self directed retirement plans are under the major misconception that if they hand off some Morningstar profiles for mutual funds to their plan participants, the investment by said participant in those funds will shield the Employer from liability from ERISA Section 404(c). As I always state, ERISA 404(c) is not a suicide pact. Protection from liability under ERISA 404(c) is a sliding scale, employers who provide real education on the plan investments will have less liability than those that just hand out prospectuses and fund reports. Other tips for Employers that I outlined above such as review of plan investments, retention of a financial advisor, and the use of an IPS will also maximize ERISA 404(c) protection.

1. We are paying nothing for administration.

By far, the biggest misconception Employers have is when they have the belief they are paying nothing for plan administration. Sorry, Virginia, there is no such thing as free lunch or free administration. The myth of free administration is when an Employer has a Plan using an insurance company platform. There is a misconception that this platform offer free administration and it's not true. Administration may cost nothing or very little because fees are buried in the insurance contracts and mutual funds. The mutual funds contain high expenses added by the insurance company called a wrap fee. These providers may also have a high surrender charge if an Employer changes providers before the contract expires. Insurance company providers are geared for new businesses and new retirement plans because the initial outlay is minimal. These providers make up for the "free administration" with their high wrap fees. This is why plan sponsors should constantly review the fees they pay to their TPA and decide whether that is good value in the marketplace. Fee disclosure in 2012 will help Employers out in determining cost, but it will only have any good if the Employer uses the disclosures to shop the plan around to other providers.

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